

**THE HOUSE OF ASSEMBLY SELECT COMMITTEE ON WATER AND SEWERAGE MET IN COMMITTEE ROOM 2, PARLIAMENT HOUSE ON THURSDAY 17 FEBRUARY 2011.**

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**Mr MIKE PAINE**, CEO, SOUTHERN WATER; **Mr MILES HAMPTON**, CHAIRMAN OF THE BOARD; AND **Ms CAROLYN PILLANS**, EXECUTIVE MANAGER, GOVERNANCE CORPORATE SECRETARY FOR ALL CORPORATIONS WERE CALLED, MADE THE STATUTORY DECLARATION AND WERE EXAMINED.

**CHAIR** (Mr Gutwein) - Thank you for your time this morning and also for your detailed submission. Would you like to make an opening statement or talk to your submission?

**Mr HAMPTON** - I am pleased to be here representing Southern Water. I am joined by our CEO, Mike Paine, and our corporate secretary, Caroline Pillens. Most of that which I say today in my introductory remarks represents the views of the board. Where it does not, I will indicate that it's a personal view. As you are aware, I have only recently taken over this position of Chair, so if I am unable to answer a question that you steer in my direction I will look to the support of my colleagues to help me. This morning I will speak to the major matters dealt with in our submission.

Firstly, I am effectively covering three areas: performance, governance and pricing. The financial performance of Southern Water is well detailed in pages 72-74 of our submission. We have delivered on our financial plan and in 2009-10 recorded a profit in excess of \$12 million. We have a strong balance sheet with an A credit rating and a borrowing cap of \$155 million. We have established the operating structure for the business. We have continued to manage and operate the water and sewage treatment plants, dams, reservoirs and reticulation systems. If there is an area that we haven't delivered in as we would have liked it is in billing. There are a number of reasons, but in the end they do not matter. Our customers have a right to expect better. That being said, we believe we are on track to overcoming the problems in this area. Also in our submission are a number of detailed statistics measuring operational performance.

As regard to the financial performance of Onstream, that is detailed in our submission on pages 75-76. Onstream was not expected to make a substantial profit in 2009-10, or indeed in any year. It is a service company principally providing services to the three regional corporations. However, to have delivered a close-to-budget result while managing in excess of \$12 million in operating costs on behalf of the corporations, we regard it as a positive outcome. The financial arrangements between Onstream and the regional corporations flow from direct negotiations between the CEOs, in our case, of Southern Water and the CEO of Onstream.

In relation to governance, I have a number of points. As regards ownership, the board does not see its role as to be involved in discussion around whether the corporations should be council- or government-owned. It is our view, however, that a properly functioning board should be accountable to and have a close working relationship with its owners. The present structural arrangements mean that we are not as close to our owners as we should be.

Let me turn to the issue of governance. Firstly, as to whether there ought to be one, two or three corporations, the board believes that it is too early in the life of the new businesses to consider a radical departure from the existing set of arrangements with three regional corporations, if indeed that were ever to be considered. That being said, for the record I make some observations about the pluses and minuses for one, two or three corporations. Ignoring consideration - I will park Onstream for the moment.

The relationship with our council owners is challenging enough as it is. Moving to one corporation will only make it more difficult to maintain communication and receive input from 29 different owners. The issues in each region, as we are increasingly discovering as the corporations develop, are distinct and in many areas may be better handled in separate regional corporations. On the other side of the ledger, Cradle Mountain is in a difficult financial position relative to the other corporations - a more challenging financial position - carrying significant debt. So, from the point of view of that corporation, a combination with either one or both of the other corporations might make sense. I guess the question is: is that equitable to the owners of the other corporations who chose not to transfer significant debt across when the corporations were established.

The efficiency benefit of one corporation versus two or three can largely be secured by sensible cooperation between the three corporations. It is my assessment, having been a common director from inception and previously a direct chairman of Hobart Water, that the additional cost of having three corporations versus one corporation is likely to be less than one per cent of operating costs. I will leave it to others to form a view as to whether that is too high a price to pay or is a small price to pay for the greater focus and closer relationship with owner councils that the three regional corporations would deliver.

We turn then to the owners' reps process and our comments are at page 42. Under the current legislation, the accountability of the board, the owners, is via owners' representatives. However, despite the best endeavours of the owner reps, this arrangement has left many councils feeling disenfranchised as owners. Councils are increasingly seeking to bypass the formal arrangements and deal directly with the corporation. The board of Southern Water recommends that each council has a representative under a model not dissimilar to that of the former bulk water authority where the board responds to a group comprising representatives of all of our owners, not just some of our owners.

**CHAIR** - So how many councils do you represent that Southern Water is responsible to?

**Mr HAMPTON** - Twelve.

**CHAIR** - So you'd like to see a board of 12.

**Mr HAMPTON** - Not a board of 12; I'd like to see us answering to an owners' group of 12.

**CHAIR** - As opposed to -

**Mr HAMPTON** - The former bulk water authority in the south was owned by eight councils because only eight were taking bulk water and we responded to a group of eight. It was not difficult.

Turning to the appointment of directors: while it will not necessarily always be the case, at present the selection committee with the appointment of directors currently includes no representative of southern-based councils. The actual selection committee for the board of Southern Water has no representative of the councils today. That could be different if a different selection committee were appointed.

**Mr HIDDING** - Who appointed the committee?

**Mr HAMPTON** - The committee is actually structured under legislation. There is the secretary of Treasury, a representative of the councils and an independent person deemed to have knowledge of corporate governance. Presently, it is the secretary of Treasury, Mike Vertigan, in terms of governance, and Lynn Mason representing the councils but of course she is not a southern-based councillor so -

**Mr HIDDING** - Did the councils choose to appoint her?

**Mr HAMPTON** - The councils, on a statewide basis, appointed her. We are here today to talk about Southern Water. Southern Water doesn't actually have anybody on that committee at this point in time. That may change sometime down the track.

The selection committee, comprised as I've just outlined, makes a recommendation to either the statewide owners' group, in the case of common directors, or the regional owners' representatives in the case of regional directors. The latter groups are not able to make an appointment outside of the recommendation from the selection committee. So a selection committee on which they are not represented puts forward names and says choose between them. In this process many councils feel they have little say and it is hardly surprising that many feel disenfranchised. The board has the view that the recruitment and appointment of directors and the chair should be the responsibility of the owner councils. This was the case with the former bulk water authorities and I do not believe there was any criticism with the outcomes of that process when they existed.

Let me turn to 'common directors', an unfortunate choice of terminology but it is in legislation and I have to go under that title as a common chair -

**Mr HIDDING** - Better than an uncommon one.

**Mr HAMPTON** - Indeed, sir.

The introduction of the position of a common director and common chair was presumably aimed at a degree of consistency across the State. This may well have been achieved. However it has created a situation where the regional directors, on occasion, feel disenfranchised and the demands on common directors are extremely challenging. But having common directors is not necessarily to achieve consistency. The regulatory constraints are such that on most important issues a consistent approach is likely to occur. Our space is so well regulated in terms of economics, health and the environment that in my view there is not a need to have common directors to ensure consistency, if that indeed was the reason they were there in the first place.

While having common directors and a common chair may well have served the corporations well in the initial phase, it is the board's view that at some point in time there should not be a need for either common directors or a common chair. That statement is taken from our submission. My view is even stronger: I consider the common director-regional director model is at times unhelpful. I will give you an example of that. Mr Paine was originally appointed as CEO of Cradle Mountain Water and four common directors were involved in his appointment. When we had a vacancy in the south, Mr Paine put up his hand. The four common directors on Southern Water in a sense had a conflict of interest: do we want to persuade Mr Paine to come south or should we leave him in the north? As board members of Cradle Mountain should we have thrown a package at him so high that he couldn't refuse it to stay on the north-west coast? There can be a conflict there and it arose in that situation. Fortunately he determined that he wanted to come south, fortunately for Southern Water.

So I feel very strongly and in the process I am saying to you that, having only recently taken the position of common chair on the board, I do not believe there should be a common chair now. It may well have served us well to get to where we are at but it is time to think about moving the organisations forward.

In terms of GBE scrutiny, the corporations are owned by councils, not the State Government. It seems unusual that a corporation that is not owned by government is subject to GBE scrutiny. The real difficulty with that is that it reinforces that we are actually serving two masters. Every year we have a series of annual general meetings with our owners but our owners actually don't get to approve anything. Our owners, as a group, don't get to approve the accounts or appointments to the board so you would almost ask why we would have an annual general meeting in that circumstance. The board's view is that the corporation should not be subject to GBE scrutiny when we are owned by councils.

Let me turn now to the Onstream structure. Onstream, as you well understand, is a company that is owned by the three corporations. There is some misunderstanding in the community that in fact it sits over the top of the three corporations, but that is not the case. It sits underneath the three corporations and it is owned equally by the three - one third each. It has its own board, comprising the CEOs of the regional corporations, the common chair and two additional directors approved by the Treasurer. The board composition does not reflect good corporate governance. That was reasonably clear from day one where the CEOs and indeed the common chair - and while I was sitting there, another common director - were essentially conflicted on a range of issues. They are representing Southern Water or they are representing Onstream. It is the view of the board that the Onstream structure should not be prescribed by legislation but left to the regional corporation boards to determine the appropriate form. A simple joint venture agreement between the regional corporations in our view is all that is required and if such approach were to be adopted the statutory conflicts of interest would in fact be removed.

Let me turn then to Onstream operations. There is no doubt that some of the activities of the regional corporations will almost always be most efficiently undertaken under some form of joint services agreement. The legislation and constitution defines certain activities that Onstream must undertake on behalf of the regional corporations. Southern Water may wish to undertake some of the prescribed activities on its own behalf but it is

actually not permitted to do so. There is a clear list of things that Onstream has to do. Onstream has not decided to do them, the boards of the regional corporations have not decided that Onstream should do it for them, and the legislation says you have no choice. As a result of there being no choice in the current set of arrangements there is an absence of competitive tension. We consider it undesirable that there be any prescription of activities. It should be left to each individual corporation to determine which activities it wishes to conduct on its own behalf and which activities it wishes undertaken under some form of joint services arrangement.

Moving on from governance then to pricing issues, I will start first with the removal of the price cap. The original IPO that was to apply for the first three years provided for a maximum 10 per cent increase in prices per annum per customer over what they had previously been paying. In November 2009 the Government announced a price cap limiting the price increase in the first three years to 5 per cent per annum, with the Government making up the shortfall to 10 per cent. In 2009-10 Southern Water received a rebate of \$2.8 million. In 2010-11 we estimate it to be \$6.4 million and 2011-12 we estimate it will be slightly in excess of \$11 million. If the Government price cap rebate is removed from 1 July 2012 we will have to either increase prices substantially or reduce dividends to our council owners or a combination of those two and it will be a significant adjustment even if it is spread across those two areas. The adjustment process will be much easier to manage if the price rebate is removed gradually over a number of years. In addition to seeking a phasing out of the rebate we believe the manner of the application should be changed. The rebate is not targeted and therefore the larger the account the larger the rebate.

**CHAIR** - The 5 per cent price cap winds in around \$30 million statewide of government assistance at the end of next financial year, then from 1 July 2012 it is finished. Have you modelled what impact that would have on the customers in the south if the entire increase were to be paid for by customers? Is it just 15 per cent or a 20 per cent increase?

**Mr HAMPTON** - Our present revenues are about \$110 million and so \$11 million is coming from the Government. Our revenues will be up by then to maybe \$120 million so we are talking about close to 10 per cent adjustment if it all went to prices for that by itself, plus what other price increases might be necessary.

**CHAIR** - Do you think that they will run to the 10 per cent or around that level normally?

**Mr HAMPTON** - To cover in detail how the overall price matrix will work out, I will go to that now, if I may.

**CHAIR** - Please do.

**Mr HAMPTON** - Just finishing off on the point that I was making about the rebate not being targeted, for example there is one customer in southern Tasmania who received a rebate of \$140 000 and the average customer rebate was \$57. If the Government agrees to phase out the price gap rebate, which indeed is our hope, over a period of time, it might be appropriate to target the assistance that they continue with towards those customers most in need.

Turning then to your question, Chair, future price movements to our customers will be determined by two discrete drivers. The first is the business requirement for additional revenues and, secondly, there is the need to transition from the many different pricing arrangements currently in place to an equitable structure based around cost recovery. We do not have any choice on moving to an equitable structure on cost recovery, that is there in legislation, so there are two distinct drivers.

Let me look at the first one, the business requirement for additional revenues. Like any business our costs will increase over time. That being said, we will be doing our best to keep those costs of running the business to an absolute minimum but our situation is a little bit more challenging because we are not a status quo business, we are charged with undertaking a significant capital works program for the community in southern Tasmania estimated in excess of around \$500 million and our own work tends to point into that target range. Every \$10 million that we spend on capital expenditure effectively adds approximately \$1 million to our interest expense and depreciation expense and sometimes even when we spend money to improve our operations in addition we actually have higher operational costs. You can do the arithmetic as quickly as I can, I am sure. If we have to spend \$500 million that suggests over a period of time there is a significant non-status quo increase in our costs relating to funding the capital works program, providing for its replacement with depreciation and the additional operation of x cost.

**Mr MORRIS** - Could I just get some clarity? That capital works is actually the shortfall that has been identified from where we are at the moment and moving to instantly full compliance with the health requirements for the sewage treatment plants and for drinking water all being up to reasonable infrastructure and quality standards as in potable water. We are not talking about an ongoing capital works program; this is just the shortfall, isn't it?

**Mr HAMPTON** - This is remedying the inadequacies in our present system but not instantly. We simply could not do it instantly. The original intention, I believe, was around 10 years and the question has to be asked is 10 years the appropriate number - is it too quick, is it too slow? Realistically can we in fact roll out that kind of capital expenditure? We think we probably can so it then comes down to the question, are you trying to do it too fast in 10 years? It is a significant cost impost.

**Mr HIDDING** - Just on that question, you mentioned earlier in your overview that you have a borrowing cap. Who determines that?

**Mr HAMPTON** - Effectively Tascorp determine that because we borrow through Tascorp and they look at our balance sheet today and that is an umpire decision today. As we go forward, if our balance sheet improves our borrowing capacity will go up.

**Mr HIDDING** - So there is a direct correlation between the political decisions on rebates et al to your trading operations, to your balance sheet, to your borrowing capacity, to the time line by which you can deliver?

**Mr HAMPTON** - Within borrowing capacity that then flows on to our interest rate, the interest rate that we pay on our borrowings. It's a significant non-status quo. If we can keep our status quo costs at 3 per cent, or 5 per cent, we then have this impost on top of it. We are charged with improving the rate of return on the assets that we are managing

on behalf of the community. We have about \$1 billion worth of assets and the suggested rate of return has been somewhere between 6 per cent and 7 per cent. That is what we should be targeting. Clearly if the industry is presently below 2 per cent, Southern Water is 1.5 per cent. If we are targeting to make that kind of surplus in even 10 years' time the rate of increase in prices to our customers again has this other factor coming into it, so we have a second non-status quo.

**Mr MORRIS** - Is it not a fact that if that rate of return was reduced to the industry average, it would reduce the pressure for price rises?

**Mr HAMPTON** - Very substantially.

**CHAIR** - Have you done any modelling in regard to what your cash flow requirements might need to be if the return was 4 per cent instead of 7 per cent?

**Mr HAMPTON** - Seven per cent puts us in an unrealistic position.

**CHAIR** - I would think so.

**Mr HAMPTON** - In the time frame that we're talking about. It might well be over 25 or 30 years to achieve the desirable objective. I still put a question mark on that, but if you try to do it in 10 years the effect in the short term is diabolical in terms of the price increases. We have modelled it and indeed we had board meetings of the three corporations with Southern Water yesterday. We have put the other parameters in place and asked our management team to work back to put those in to see what this does to the rate of return. A construction of our space seemed largely to be around the fact that we have to have all these price increases, we have to do all these things, and therefore the customer will pay. The board has taken the view that we have a number of different levers and all of our stakeholders may have to take some pain. We will have to take some pain by being extremely efficient. There are a number of quite complex levers that I will come to in a moment when I talk about the second driver.

**CHAIR** - In regard to the return on assets, obviously that will have a major impact on your owners. Have you had discussions with your owners about the potential for a lower return on capital?

**Mr HAMPTON** - We haven't had a conversation with them directly on the effect on them but I would have to say that in the direct communications that I've had over the past two years and more recently with our senior people in councils they are challenged by us seeking that kind of return, knowing full well that if we seek that kind of return and we have a 50 per cent payout ratio of our dividend, it goes straight to them. It becomes a little bit circuitous. If we boost our profits and pay it out to them as dividends, they then spend it in the community or keep their rates lower than they otherwise would be, it is a bit of a circuitous space. The overwhelming view I'm getting is that they are struggling. They fully understand because they all knew what kind of rates of return they were getting from their assets in this space and very few of them were anywhere near the kind of return that is being flagged as desirable.

**CHAIR** - What is your experience with other corporations Australia-wide? What sort of return on asset are they looking for?

**Mr HAMPTON** - My experience is a much lower number than 6 per cent or 7 per cent. Mike has worked in other parts of Australia.

**Mr PAINE** - Yes. There is a move towards sustainability - whatever that means. The weighted average cost to capital is generally lower than 7 per cent, but you have to compare chickens with chickens. The 7 per cent we're talking about is pre-tax, where most regulatory regimes talk about post-tax rates of return. Is anybody there at the moment? I doubt that very much. There is an ongoing overtime trend to move towards that position but they're not there yet.

**Mr HAMPTON** - I don't think you can look at the rate of return in isolation. You have to think about whether you going to be paying it out back to your owners because if that's what you're doing then you have to ask the question, why is this circle there?

**Mr PAINE** - And perhaps the model in Tasmania of being a council-owned model doesn't necessarily apply to the major regulated businesses elsewhere; they are generally government owned.

**Mr HAMPTON** - Moving on to finishing off the business requirement for additional revenue, the third one is that our owners have an expectation that we will increase our dividends over time - we have just been talking about it. As you would all understand, we are presently in a phase where certain of our owners have a priority distribution and that runs for five years. Let me give you an example. Glenorchy City Council are presently receiving about 60 per cent of what we pay out in either dividend tax equivalents or loan guarantee fees, which is giving them a payout from us of the order of \$8 million at this point in time. The priorities get paid before there is any distribution to the balance of our share - our owners.

**Mr MORRIS** - Does that reduce each year or is that constant over the five years?

**Mr HAMPTON** - It is constant over the five years.

**Mr PAINE** - Percentage is constant for the five years.

**Mr HAMPTON** - When we get to the end of the five years, to maintain that payout in dollar terms to Glenorchy - so no real increase, but in dollar terms - their entitlement after year five is 21 or 22 per cent of what we pay out.

**Mr HIDDING** - Which side of the operating statement are we on? Glenorchy takes its dividend before other distributions are considered, so it is an operating cost?

**Mr HAMPTON** - I gave you Glenorchy as an example. Because certain councils were deemed to be making money out of water and sewerage, and some councils were deemed not to be making money - and that was ultimately a treasurer's assessment and decision - we have effectively received an order that for the first five years of our life all distributions to owners will go first to those who are deemed to receive a priority distribution. It is after profit, so it is not an expense. When we send the tax payment, that is equivalent payment every quarter and it is shared amongst those owners entitled to a priority distribution. The same with the loan guarantee and then the same thing when



we declare a dividend. It is only when we get above the aggregate of the priority distributions do the other owners who do not participate in that start to get something.

**Mr MORRIS** - Can you provide the committee with a list of payments for the priority dividends that were made this year?

**Mr HAMPTON** - Yes. I am just using Glenorchy as an example. The others who are receiving a priority distribution are in the same space but perhaps not to the same degree.

**Mr MORRIS** - That is why I am wanting that list so we can have a look and see what that appears to be doing.

**Mr HAMPTON** - But if our owners, particularly those receiving a priority distribution, have an expectation, which I believe they do, that their dollar receipt will not drop, then our aggregate distribution, in this case to keep Glenorchy happy, will have to trickle because otherwise we can't maintain the dollars. So there is this additional driver that we have to generate enough profit to pay an increasing amount to our owners.

Finally, we have the challenge of the removal of the price cap, which I talked about a moment ago.

**CHAIR** - With the challenge of finding an increasing amount to your owners, the direct correlation is that there is going to be an increasing price to customers to provide that revenue stream. Have you had the discussion with your owners about what the impact will be on customers should they remain steadfast in regard to their expectation from dividends?

**Mr HAMPTON** - We have not had that conversation. There are two reasons why we haven't had that conversation. We are waiting for the pricing regulations to formulate, from our own point of view, our draft prices and services plan. Once we have formulated that, our intention would be to start discussions with all our stakeholders as to the reasonableness of what we are putting forward. As I said a moment ago, there are a whole series of levers here and if one group gets everything they would like there is a fair chance that most other groups will not get very much of what they would like out of the various outcomes. There is absolutely no doubt that our revenues will need to increase, beyond our growth in operating costs of the business. However, we are determined to keep it to an absolute minimum and to that end we will be seeking to minimise and/or defer capital expenditure where possible. To minimise, we look for the best possible solution to capital expenditure. If we can turn that \$500 million into \$400 million then that will be a great outcome for the community, so we are taking the time to look for the best solutions, not just rushing out and spending the money. Mike can give you some examples of that, if you like. If we are struggling with the arithmetic in keeping the price rises to a minimum using the 10-year time horizon, we will look at it maybe a 15-year time horizon. It doesn't have a huge impact but small wins added together enable you to keep the adjustment process to our customers to an acceptable level. So minimising and/or deferring capital expenditure and keeping a really tight rein on our operating costs. The boards have sent a message to our management teams - and the board of Southern Water has sent a message to its management team - 'We are looking for you to deliver productivity gains. We know you have complexity of new things coming on that you have to manage but we are looking for productivity gains'. Let's face it, a lot of

people and assets were thrown in our direction and that's why we are encouraging the time to be spent on finding the best overall solution rather than rushing out and being seen to be doing things in a hurry. We will be seeking, and I don't think there is any doubt that we have to seek, a conversation with government and the regulator about the targeted rate of return and/or the period of time within which we are expected to achieve it. If we are targeting 6 per cent to 7 per cent and it's 10 years, we're in a very difficult space.

**Mr MORRIS** - It basically doesn't add up.

**Mr HAMPTON** - It doesn't add up. We will be seeking to negotiate with our owners around the dividends. Everyone is going to have to share some of the tightening if we are going to end up with a price increase to our customers that's half acceptable. Finally - I am hoping if I say this often enough we will be listened to - a phasing out of the government rebate will help us in keeping our price increases to a minimum.

**Mr MORRIS** - What happens if it stops dead? There is no proposal that I know of to phase it out.

**Mr HAMPTON** - As I mentioned earlier, essentially we have two immediate choices: either putting up our prices, which we flagged was probably about a 10 per cent increase - just on that alone, ignoring the other factors; or reducing our dividends - it would have a substantial impact on our dividends - or a combination of the two.

**CHAIR** - In regard to the other factors that are driving prices, setting aside the increase customers will need to bear when the cap is wound out, what reasonable expectation do you have as to what price increases may need to be under the current model? If you were to maintain the current target of 7 per cent return on weighted average cost of capital, if your councils or owners remain steadfast in their desire to see the dividend stream arrive at the time frames that were originally proposed? What sort of increase do you think the customers could potentially be facing?

**Mr HAMPTON** - We have done some modelling around this space. It depends on the period of time that you are looking at. If you were focused on the original planning horizon, which was 10 years, you would have to be looking at compounding increases in excess of 10 per cent - and even then you may struggle. If all the stakes in the ground stay where they were originally planted that is what we would be looking at.

**CHAIR** - So over a 10-year period, more than a doubling in what people would be currently paying?

**Mr HAMPTON** - That is correct.

**Mr MORRIS** - Compounding 10 per cent?

**CHAIR** - Well in excess of the doubling.

**Mr HAMPTON** - Hence our focus on trying to enter into dialogues about believers but we need to try and see what we think operationally will work.

**Mr PAINE** - There are a number of factors in planning for that that will come into play - operational efficiency things like that. You cannot model in the status quo around that because the investment is nothing, so it is a simplistic answer to say what is the likely impact. These complexities are always challenging.

**Mr HAMPTON** - That is the first group that I call business drivers' group. The business drivers' need for additional revenues.

Let me turn to the second area of complexity and that is the transition because if everyone were being billed in the same way the numbers we have talked about would apply. But we have a more difficult circumstance than even that might suggest.

Currently we are billing our customers under a multitude of different tariffs reflecting the many, many different ways that councils were previously billing their customers. Some of our customers were paying too little and others were paying too much. In 2009-10 Southern Water residential customers paid in the range of \$300 to more than \$8 000. That is the range that we inherited and we simply had to apply the basis that was there in the past and then apply, if we chose to, the maximum increase that was allowed. We have not been able to play with that process. Under legislation we were deemed to have to go down the path that we did.

**CHAIR** - I am sorry to keep jumping in but this is vitally important to understand. Have you modelled like customers in different municipalities with no meters where it is all based on AAV? So with similar sized households in similar areas but in different municipalities, is there a vast difference? If you have somebody with a four-bedroomed house in Clarence versus somebody with a four-bedroomed house in Hobart, how would they be being treated at the moment?

**Mr HAMPTON** - Of course when it is purely AAV-based it is entirely based on the valuation of the property and therefore the cents in the dollar rate struck by the council and the value of the property determine it, not the size of the property or how many people live in it.

**Mr BACON** - Two houses in different municipalities will pay different -

**Mr HAMPTON** - At the moment.

**CHAIR** - That is the point that I was making because you have inherited the previous -

**Mr HAMPTON** - And in some cases quite significantly.

**Mr MORRIS** - That works all in the original final report of the regulator.

**Mr BACON** - And your ad being in the *Mercury*.

**CHAIR** - In the north of the State metering currently exists. Have you considered what would occur if a similar property in the south was metered or charged at similar levels to what is being charged in the north of the State?

**Mr HAMPTON** - The situations in the other two corporations are slightly different. As you know, of course, people tend to think that the south is unmetered but in fact it is significantly metered - in fact the proportion is -

**Mr PAINE** - Twenty one thousand with no meters plus others.

**Mr HAMPTON** - Of course some councils in the south are already metered and they have two-part pricing. Brighton would be a clear example of that.

**Mr PAINE** - And parts of Clarence.

**Mr MORRIS** - Can I ask you a couple of questions about the prices and services plan? My understanding is that you are required to draft up a prices and services plan for negotiation and/or agreement by the regulator, is that correct?

**Mr HAMPTON** - That is correct.

**Mr MORRIS** - Do you have a draft prices and services plan at this point in time?

**Mr HAMPTON** - No, we don't but I would have to say that our thinking is well down the track. One of the reasons we don't is that we actually are still waiting for the pricing regulations to come to us and we don't yet know the extent to which they will impact on our thinking.

**Mr MORRIS** - Have you been given any indication when they will come?

**Mr HAMPTON** - We have just recently been given a draft in confidence to provide some feedback on and our people are looking at that so, hopefully, the final ones will not be far away.

**Mr MORRIS** - Who does that come from - the Treasurer or the Water minister?

**Ms PILLENS** - It comes via offer regulation that will come through the minister.

**CHAIR** - That has come out of the process of the review of the IPO or the -

**Mr MORRIS** - It is part of the process, I think.

**Mr HAMPTON** - It was always going to be, it was defined as part of the process so what we could or could not do in the first three years was defined and we are now moving to what happens beyond and we were going to be given some guidance about what was expected in our prices and services plan in these regulations. We have a reasonably good idea and in some areas of our business we are more advanced in our thinking than in others. I would say that we have been giving most of our attention to the effect on our residential customers. We have not done as much work as we would have liked from our commercial customers' point of view.

**CHAIR** - And that takes effect from 1 July 2012.

**Mr HAMPTON** - Yes, 2012. We are obliged to prepare our plan and, as I mentioned, we have committed as an organisation - and some of my colleagues are probably unhappy - I committed on behalf of the three corporations that the three corporations would make their prices and services plan available no less than four weeks before we are due to lodge it. We have been embarrassed that we have not been able to come out and say what we think the price will be in 2012-13 and so we have committed to making our thoughts available for the community's feedback to us before we submit our final one to the regulator. It is quite possible that the regulator will then decide to have their own exposure period. Let us face it, they have a 12-month period in which to do it.

**CHAIR** - So when must you have your plan to the regulator?

**Mr HAMPTON** - At this point in time we are due to have it on 30 June.

**CHAIR** - So four weeks prior to that you will make it available.

**Mr HAMPTON** - Yes. Over the past series of board meetings we have been receiving reports from management and providing feedback and asking for more work to be done. Mike, you wanted to add something.

**Mr PAINE** - Just on the other aspects of the pricing and services plan they are pretty much down the track in terms of service levels and customer code and all those aspects.

**Mr MORRIS** - It is the pricing that is the tricky one.

**CHAIR** - Just the sharp end.

**Mr MORRIS** - Yes. There is another aspect that I wanted to pick up, if I might at this point which is probably appropriate. From your submission to us on page 103 under 6.3 you talk about the rebalancing exercise that was undertaken by councils in 2008-09, which meant that the corporations had less income than was forecast or calculated to be coming in by the regulator or the Treasurer. Has anyone done any work on exactly what each council did in terms of that rebalancing? I know that the Hobart City Council in that year chose not to increase its water and sewerage rates but did increase their normal rates - a little bit of a rebalancing, but not radical. Do you have a list of what happened and how much less income the corporation received than was anticipated? How far back were you set from the original starting point you anticipated?

**Mr HAMPTON** - Mike, I think we have that in detail, don't we?

**Mr PAINE** - Yes.

**Mr MORRIS** - Can you provide that?

**Mr HAMPTON** - Yes - we have it on a council by council basis. It's our view, on the basis of the information that we have - we may not have all the information but we've done our own assessment of what we missed out on.

**Mr MORRIS** - If you could provide that, it would be much appreciated because I think it may well have a relationship to the priority dividends - I don't know and I won't know

until I've seen it. Whilst I know where to find the information, I haven't got the resources to do that work so if you have done it, that would be a great help to us.

**Mr HAMPTON** - Can we go back to the issue of transition which I had started?

**Mr MORRIS** - Yes.

**Mr HAMPTON** - Customers paying in excess of cost recovery will have their charges reduced over time. Customers paying below cost recovery will have their charges increased. The board has agreed in principle, and we are reasonably comfortable that the regulator will land there, to postage stamp pricing so that all of our residential customers in the southern region will pay the same fixed charge and their variable charge will be the same for the same quality of water.

On a cost recovery assessment, commercial and industrial customers are presently subsidising residential customers. The first adjustment we have in transition is between residential customers but in fact there is another group called the commercial and industrial customers who, on a cost recovery assessment basis which we are obliged to apply, are paying more of our total revenues than they should be.

**Mr BEST** - Are you saying commercially - they are paying more than residential?

**Mr HAMPTON** - On a cost recovery basis they are paying too much.

**Mr BEST** - Is that right across your region or is that in pockets?

**Mr HAMPTON** - No, I think you could pretty well say it's right across. We are charging it based on AAV.

**CHAIR** - Can we come back a step to the residential customers. On a cost recovery basis, you've said that some will pay less and some will pay more. What's your modelling telling you in regard to winners and losers under that situation?

**Mr HAMPTON** - In terms of numbers?

**CHAIR** - In terms of numbers of residential customers.

**Mr PAINE** - We've got a wide range, as you know. The average pricing if you divide the total revenue from residential by the number of residential customers is around \$870 for this financial year.

**CHAIR** - So that's the average price that everybody pays?

**Mr PAINE** - Yes. So those that are below that are paying less than average and those above it are paying more than average.

**CHAIR** - I guess the question is, how many are below that?

**Mr PAINE** - I could provide that for the committee but I don't have that off the top of my head.

**Mr HAMPTON** - We'll provide it.

**Mr BACON** - What is the average cost per customer?

**Mr MORRIS** - Unfortunately this table doesn't add them up but it's clear that some municipalities are paying less.

**Mr PAINE** - The average cost is -

**Mr BACON** - Above \$870.

**Mr HAMPTON** - No. If you look at our business as a whole, \$110 million worth of revenue, a profit before tax of \$20 million - roughly. So we've got \$90 million worth of expenses, some of which relate to commercial industrial, some of which relate to residential, and getting that apportionment right and then turning it back and saying what is the true cost on a residential customer is the calculation that you're asking us to do. I don't think I can answer that off the cuff. I'd prefer not to. I could answer it off the cuff.

**CHAIR** - Have a go.

**Mr HAMPTON** - We will try to provide you with some data around that.

**Mr PAINE** - I think that's the best way to go - make sure the right information is provided.

**CHAIR** - The \$870 figure that you provided is the number of residential customers divided into the revenue that -

**Mr PAINE** - Residential customers.

**CHAIR** - Okay.

**Mr MORRIS** - So we see that Brighton Council - I've got the figures in front of me - is roughly on average at the moment.

**Mr HAMPTON** - Correct.

**Mr MORRIS** - Or thereabouts; in terms of working from a benchmark of where we are at the moment. If that's the case - if \$870 is the average now - where do you think you need to get to, to achieve the capital works program over the 10 years in terms of this average?

**Mr HAMPTON** - If we are trying to give everybody what they want and the person who pays is the customer, as we talked about earlier it is 10 per cent compounding for 10 years and maybe even longer.

**Mr PAINE** - That's on the average.

**Mr HAMPTON** - As Mike said, that's on the average. The people who are paying \$8 000 now won't be paying \$8 000 in 10 years' time, they will be paying far less, so they will still be a winner.

**CHAIR** - So at 10 per cent compound in seven years' time people will be paying double.

**Mr HAMPTON** - Yes.

**Mr PAINE** - There is a caveat on that, Mr Chairman. Regarding the full operational efficiencies, the full review is of the ability to plan without boundaries and provide solutions without boundaries. It may not be the \$500 million and we are spending some time to make sure that we come up with the lowest overall cost. That is a key goal of Southern Water; it's a key goal of all the water corporations.

**Mr HIDDING** - It was the point of the whole thing, wasn't it?

**Mr PAINE** - Correct.

**Mr HIDDING** - There had to be some efficiencies of taking down boundaries.

**Mr PAINE** - Absolutely.

**Mr HAMPTON** - We are starting down a path of trying to benchmark our costs of operations vis-a-vis other people who have been established for some time so we can set our own targets as to where we think we ought to be going in terms of managing our business efficiently.

**Mr PAINE** - That's a big piece of work, though.

**Mr HAMPTON** - In pricing there are two groups, the business needs and the transition. I have already talked about the transition for residential, just between residential. We have identified that our commercial industrial customers are paying too much on a cost recovery basis. That is another overlayed increase on the residential customer. Our estimate is that certainly in excess of \$10 million extra is being paid. The cross-subsidy from commercial/industrial is at least \$10 million and possibly quite a bit higher.

**CHAIR** - So based on what we were discussing earlier with a revenue base of around \$120 million, and we talked about the \$11 million of government subsidy, business is currently subsidising residential by a further \$10 million?

**Mr HAMPTON** - At least, in our preliminary view.

In summary therefore, where a residential customer has been paying too little relative to other residential customers, so they are below the \$900 or \$870, the price increase that will apply to them will be reflective of the transition within the residential group plus an increase to reflect fairer charges to commercial industrial - fairer being cost reflective - plus an increase to reflect our business need for additional revenues that are highlighted. The space that we have is a very challenging space.

While we are yet to finalise our thinking, we are getting close to it. It is likely that we will be recommending a side constraint, limiting annual increases for residential customers to the greater of a nominal dollar amount or a nominated percentage of the bill so that our residential customers will transition and the length of time it will take them to



transition will be dependent on a number of factors - how far below the average rate of charges today but also what we can do to keep the other increases that we need to an absolute minimum. Quite clearly under the legislation we and the regulator are required to seek to minimise price shocks.

When we work out what we need, we work out the adjustment residential/commercial, then we have what sort of price increase is acceptable for an individual customer over a period of time.

**Mr MORRIS** - Does that follow that the side constraint would also have to apply to price decreases for those who are currently paying over and above?

**Mr HAMPTON** - Absolutely, otherwise we have a problem in terms of the finances of our business. Just as the price increases will have to go up steadily, the price dropping off will have to go off. The informal indications that we have had from the Property Council, for example, is that they're not uncomfortable with it happening over a period of time.

**Mr MORRIS** - Could that side constraint also apply for the imbalance between commercial and residential?

**Mr HAMPTON** - There is no reason why not. All people who lose transition and people who win will have to transition because otherwise we might end up with the shock, in which case our owners would ask for us to be removed because we won't be paying them anything at all by way of dividend.

**Mr HIDDING** - Is it not true that something has to give? If you are continually looking for appeasement through side constraints - it is a regulator's job to manage price shocks and I guess it's your job to submit cases to the regulator that he could agree with, so you have to try to out-think him - is it not so that your other business settings, such as the 10-year settings, are driving this? When would you be putting your hand up saying to your owners, to the Government or to this committee, 'Our basic settings are wrong. We can't manage price shocks' - if we are talking about a 100 per cent increase over seven years? How do you say that without that being a price shock?

**Mr HAMPTON** - The board of this corporation has not accepted that as an acceptable outcome. We are targeting to achieve much lower increases in our revenue requirement. The serious complexity is those people who are only paying \$300. If we can keep our revenue requirement, balancing the owners' desires, keeping our costs down, managing capital expenditure efficiently, maybe extending the period, persuading the regulator that maybe in 10 years time 3.5 per cent is a more sensible target, we can probably keep the need for additional revenue in the range of 5.5 per cent to 6 per cent.

**Mr HIDDING** - So we're talking 90 per cent, not 100 per cent.

**Mr HAMPTON** - That's in the headline revenue number but that transition number, where someone is only paying \$300 - and in today's dollars we have to move them from \$300 to a round number of, say, \$900 over a period of time - the actual dollar amount changes in real terms.

**Mr MORRIS** - The other thing that hasn't really received much discussion that would have a huge impact on all this would be if governments continue to do what they've done in the past, which is put in specific moneys for specific capital works so that if the burden of the capital works was to be lifted that would make the transitional pricing a whole lot easier. There is an assumption in this at the moment that, apart from the \$10 million that has been given by way of grant for the metering project, there is no anticipation of any government funding, yet councils have been receiving direct Federal and State government grants for capital works projects for ever and a day. It now seems to be an assumption that that has come to a complete grinding halt.

**Mr HAMPTON** - I know that the former chair, some of the management team and some councils that have a particular interest in this space, did a lot of work on working up ready-to-go projects with a view to seeking Federal government assistance in that space. I may not be completely on top of it but my understanding is that today our expectation is not very much, if anything at all. In other words, perhaps our reform was two years too late. The money is not there today to help us in the way that had been flagged to us two years ago. We did the work but the reality is we are not expecting it. To answer your question, in Victoria, when they did their reform process, the State Government kicked in around \$480 million to the water authorities to help them with this transition.

**Mr HIDDING** - On the question of this transition, you mentioned the Property Council said they understood there would be a transition. Many of the currently unmetered businesses who are paying on AAV are small businesses who would have nothing to do with the Property Council, frankly. It is their view, I believe, that they have been waiting for water sector reform and it has arrived. The policy is here, the new water structure is in place, a meter goes in, so they should be able to expect a user-pays system. Is it not a case for you to say to the Government or to your owners that you should go to the Government and come up with a price-shock-buffering package of money. Let us run our business on the hard policy, which is the position you have been taking, and if there are price-shock issues out there then you manage them. It seems to me that you people are dealing with increasingly complex matters such that you can say, 'Yes, price shock for fairness' but it could also be price shock in terms of political pain. Do you understand?

**Mr HAMPTON** - Yes, I do understand.

**Mr HIDDING** - The Government would want you to keep their backsides out of the fire by increasing holus-bolus within your businesses where you are saying to the business community, 'Sure, the policy changed but you're going to have to contribute to the poor householders who have got to come to the normal limit'. Should there not be a political bucket of money which would -

**Mr HAMPTON** - I don't think that is our space, Rene. The reality is we have legislation, we are obliged to follow it and our strong focus across the three corporations, with Southern Water here, is that our owners have communicated to us that they are terrified about the 10 and 10 and 10 in representing their constituents. If it wasn't going to be there then it was always going to come from our owners, but our focus is on how can we manage all of these to keep things half acceptable for most people in the State. We would love to be able to turn around and put forward a proposition that says the small business owners will get more immediate help than the larger business owners, but are we at this point in time

charged with making that judgment call? We are not charged with making that judgment call; we are charged ultimately in having an equitable, cost recovery-based business and we are charged with developing a transition plan to get there. There is no doubt that our life would be a lot easier if we were able to afford lower price increases and to help those in the community. I flagged earlier that in terms of the price rebate we think it would be far more sensible to target that, and the same may well be true of commercial. We can flag that as an issue but it is not in our space today.

**CHAIR** - Are the owners considering it? What you have mentioned today most people who have taken an interest in this area would have already recognised. The way to do average cost of capital was creating an issue, the dividend streams to councils over time were going to create an issue and place upward pressure on prices and then obviously the cross-subsidisation issues which you have just been through. You mentioned that some officers of the corporation had sought to explore Federal Government funding options. Have the owners as a group spoken about this? If memory serves me correctly, when this was first flagged one of the distinct memories I have is of Michael Aird taking on Malcolm Turnbull there may be a requirement for \$300 million added to the National Water Initiative back in 2006-07. There was quite a bit of pressure on Mr Turnbull prior to that Federal election. Is anybody taking that fight up at the moment collectively on behalf of the corporations? More specifically, are the owners doing that?

**Mr HAMPTON** - I can't answer for the owners; I can only repeat what I said a moment ago. My understanding is that the former chair worked with a group within the corporations and with some of the councils who had a particular interest in that way. At least one GM from one council who had a particular interest in that had some meetings with the head of Infrastructure Australia -

**Mr HIDDING** - That is fields apart from, as the Chair has just put it, the early position of the Treasurer of Tasmania who said we were going to need \$300 million for this deal to stack up from national water initiative funding which was there - you are dead right - and notionally available at the time. You just said that you cannot speak on behalf of the owners. Who can? Are you not the chairman of Onstream?

**Mr HAMPTON** - I am the chairman of Onstream and the chairman of the four corporations.

**Mr HIDDING** - Which is the group of owners?

**Mr HAMPTON** - No.

**Mr HIDDING** - No, no sorry that is the operator. So who does speak on behalf of the owners?

**Mr HAMPTON** - Formally in the three corporations we deal with the three representatives under the reps process that I talked about earlier. Officially we do not have a direct communication with our 29 owners. The only communication we have with them officially is when we have an annual general meeting and they are invited to come along and listen to us tell them what a good job we have done. We give them afternoon tea, but they do not get to vote on anything.

**CHAIR** - I am sure we are going to hear more about that through the course of the day.

**Mr HAMPTON** - I suspect you might.

**Ms PILLENS** - May I just clarify formality however? The shareholders' letter of expectation that is signed off by each of the owner-councils in each region specifies quite clearly that the corporations are encouraged and indeed expected to chase whatever Federal funding is available. So that formal requirement is on the board and we have been moving through those processes as Miles and Mike have explained. However, the statewide owners' representatives groups - the three representatives in each of the three regions - meet together with the board chair at least twice a year as a standing arrangement and more often for other reasons but at each of those meetings at which I have been present the subject of Federal funding has been raised each time, our owners are very conscious of it, our boards and our management teams are very conscious of it, the opportunity at the moment is what we are looking for. So with the spade-ready projects we mentioned before, we have those proposals ready to go for when that next batch of funding becomes available.

**Mr HIDDING** - Have there been applications to infrastructure projects?

**Mr HAMPTON** - Yes, and because we are talking big picture, it may well be that councils who might have only been talking about a particular treatment plant somewhere, something a lot smaller, might well have had, in the past, a better response than we get when we go in with a larger application and our application was very significant.

**Mr MORRIS** - Have the shareholders' letters of expectation been published?

**Mr PAINE** - Yes, they are on our website.

**Ms PILLENS** - They are on our website and they have been accepted by the Treasurer as they were signed off each time, as is required under legislation.

**Mr HAMPTON** - There is a very formal process for their preparation and then they become, if you like, our guidance from our owners.

**Mr HIDDING** - So if there is an expectation from your owners that you, the board members, and you, the chairman, pursue all avenues of funding and you said to us that you have tried to get some shovel-ready projects together under the Government's nose, can you assure us that there has been a full court press on the Government within the Federal budget cycle for significant funds for your three corporations?

**Mr HAMPTON** - I believe that I can and we won't lose sight of it. The fact that the indication to us at this point in time is that moneys will not be forthcoming does not mean that we will resile from our desire. As I said a moment ago, every \$10 million worth capex that we have fund adds \$1 million to -

**Mr HIDDING** - So it is urgent and as part of working the budget cycle you need to work the political structure as well, so you need to brief the Federal Opposition and under the peculiar arrangement in the Federal Government at the moment there are probably a few others you need to brief as well, including independents and upper House people. I am not hearing from you that there is a full targeted process to go back to the Federal

Government. Initially there was a \$300 million hole that needed to be filled by the Federal Government and that seems to have disappeared and now we're talking about a 100 per cent increase in water charges.

**Mr PAINE** - We have an active application with Infrastructure Australia for \$250 million.

**Mr HIDDING** - What status did that receive?

**Mr PAINE** - That is in play at the moment. Infrastructure Australia funding is targeted at projects of national significance and the like. There is a regional component to it and we are confident that we'll get that space.

**Mr MORRIS** - Does Infrastructure Australia say these aren't significant national projects and point them back to the State?

**Mr PAINE** - They comment that the reforms are significant and justified but their mandate is for national significance.

**Mr MORRIS** - So we're talking about infrastructure of regional significant, aren't we?

**Mr PAINE** - Yes.

**Mr MORRIS** - How would you feel if Onstream was changed from a stand-alone company to being a subsidiary company of the corporations? Would that make administrative life easier?

**Mr HAMPTON** - It's already a subsidiary company of the three corporations.

**Mr MORRIS** - Sorry, without its stand-alone board and such - a wholly-owned company perhaps.

**Mr HAMPTON** - If you're going to have a company you will need to have a board.

**Mr MORRIS** - Maybe I will rephrase that - a joint venture partnership between the three corporations, not a separate company.

**Mr HAMPTON** - Where you did not have to have a board?

**Mr MORRIS** - Yes. Would that make life easier?

**Mr HAMPTON** - The boards of the three regional corporations have made that suggestion. I think the exact words in our submission are 'the structure ought to be left up to the boards of the regional corporations to determine that'. In the words that I used earlier I was a little bit stronger, having experienced and seen joint venture common services type arrangements that didn't involve a corporate structure. The difficulty with a corporate structure is that you then bring in directors and, if they are the same directors as the customers, is their obligation to Onstream or, in Mike's case who is a director, to Southern Water? In my case, is my obligation to Onstream, Ben Lomond, Cradle or Southern Water?

**Mr MORRIS** - All of the above.

**Mr HAMPTON** - You remove that by not having a corporate structure. That doesn't mean that you can't have an activity that is formalised under an agreement between the parties, to the extent that they want it.

**Mr MORRIS** - To achieve that we would require minor legislative change, as I understand it?

**Mr HAMPTON** - I do not believe it would be significant.

**CHAIR** - Following on from Mr Morris, Onstream was established as a common services corporation and has a fairly prescriptive set of regulations in regard to what they must provide, which leaves the corporations with very little choice. I think there were six or seven different streams when Onstream was first set up: IT, Procurement, HR. What other services does Onstream provide?

**Mr HAMPTON** - Finance, secretarial and billing.

**CHAIR** - Does Southern Water, for example, have an HR manager?

**Mr PAINE** - We do, but we have an HR manager in the industrial sense.

**CHAIR** - Can you explain what you mean by that?

**Mr PAINE** - Perhaps HR is not the right description of the service that Onstream provides; it is actually in payroll. Our HR department is focused on industrial aspects of Southern Water, so enterprise agreements and their application, training, skills development, performance and all of those - productivity around our organisation. So they are different sets; they are not a duplication.

**CHAIR** - So you don't believe that there is any duplication?

**Mr PAINE** - No; not in that space.

**CHAIR** - What about in other spaces? Finance?

**Mr PAINE** - In finance we have management financial capability so that's understanding cost drivers and structures of our business. We have had until recently a competent CFO.

**Mr HAMPTON** - The individual CEOs made representations to their board saying - Mike said, on behalf of himself and his management team - we need greater strength in this area. Southern Water by itself is a substantial business and the intent of the legislation was that the high-level CFO function would be entirely within Onstream and provided on a contractual basis across the three corporations as the corporations have evolved. The prescriptive nature was just too difficult for us but as we've evolved we've learnt about some aspects. I suppose a stand-out area is in relation to call centres. The legislation is reasonably clear that the call centres are a responsibility of Onstream. Our management teams found that there were aspects of that which were not working for them. So we've

left the contractual position of technology; the contractual arrangements for call centres are being managed by Onstream honouring that side of it but the management of the personnel on a day-to-day basis is inside the regional corporations. We've done our best within the confines of the legislation that we have been given to find solutions that keep us within the legislation but to the maximum extent possible deliver to those managers charged with running the businesses outcomes that go close to working for that.

**CHAIR** - That legislative framework sounds as though it's created some inefficiencies.

**Mr HAMPTON** - The board's very clear view is that we think there are economies of scale for certain activities but having prescription is not the solution. Let me just expand on that. Southern Water and Ben Lomond Water are in relatively strong financial positions - there are huge challenges going forward - but today Cradle Mountain Water, as I alluded to earlier, is not in as strong a financial position because of the amount of debt that was transferred across at the time it was established by its owners. A solution for Cradle Mountain Water in billing, in terms of system, may not be exactly the same solution that suits Ben Lomond Water and Southern Water - that is, because of its circumstance, Cradle Mountain Water may need to do things in a different way and be much more focused on the short-term imperative whereas given the financial strength of Southern Water and Ben Lomond Water, they may want and management may be prepared to recommend to the board a solution that, for example, might be more costly in the short term but deliver better solutions in the long term, whereas for Cradle Mountain Water there is an immediate financial imperative.

**Mr HIDDING** - Throughout Tasmanian councils there were caps on borrowings, and that is one of the reasons that you are where you are now. In spite of the fact that you have a task like this, you're only allowed to borrow this and so the task was undoable. If there were caps on borrowings, how is it that Cradle Mountain Water has ended up with so much debt, with an imbalance between debt and revenue generation? Was there one particular project or was there one council that brought in an overcooked situation?

**Mr HAMPTON** - My understanding is that it was across a number of councils. It didn't line up with the original expectation and I think that's reflected in here quite clearly in a chart, that our original expectation was a certain level of debt and it ended up materially higher.

**Mr HIDDING** - Have we figured out why?

**Mr HAMPTON** - The councils were free to make that choice.

**Mr HIDDING** - To transfer the debt or not?

**Mr HAMPTON** - That's right. It wasn't our decision; it was their decision on an individual basis. All it did was that when it came in it effectively reduced their notional equity in the corporation going forward. It seems nice and sensible but we have a company that already has 25 per cent debt-to-equity ratio, and that's probably the maximum that you should be targeting in this space, whereas I think Ben Lomond Water is 4 and Southern Water is 10.

**Mr HIDDING** - So how do you unpick that? You don't basically; you don't get them to reassume debt?

**Mr HAMPTON** - Regarding Southern Water's issues, when I am having the conversation in another place it's even more challenging and the need for some assistance - maybe the owners there would be happy to take back some of the debt, I don't know.

*Laughter.*

**Mr HIDDING** - We will tell them you said so and we'll ask them.

**Mr HAMPTON** - I would be very pleased for you to do that for me.

**CHAIR** - Isn't it a contrary position that in transferring that debt then those councils have reduced their equity and therefore the expectations of dividends in the future as well?

**Mr HAMPTON** - One would certainly hope so.

**Ms PILLENS** - Where they had expectations

**CHAIR** - With Onstream - and I am trying to get it clear in my mind where we are with that - if the current corporate structure and the prescriptive legislation that surrounds it were to be removed and collapsed and the three corporations were allowed to establish some form of joint venture partnership arrangement - however it might be constructed - is that the preferred view of the three corporations and yourself, as chair?

**Mr HAMPTON** - Yes, it is.

**CHAIR** - Have you quantified any savings as a result of doing that? I note from your submission that you say that there wouldn't be a great deal of savings.

**Mr HAMPTON** - There is the aspect of introducing competitive tension. Mike, as CEO of Southern Water, could say, 'Okay, my quotation from Onstream to supply the payroll services that it provides is  $x$ ' and he can go outside with some purpose. There is no point him going outside today because anyone that he went to would know that he can't move anyway so why would you bother. He can go to a service provider, he could consider employing his own people and make an informed recommendation to his board as to whether staying with Onstream was in his company's best interests or not, as could Barry Cash in the north and Andrew Kneebone on the north-west coast.

**CHAIR** - Is there a common IT platform across the three corporations managed by Onstream?

**Mr PAINE** - Yes.

**Mr HIDDING** - Can I review your position that you feel that having one CFO is restrictive to Southern Water, for instance. If you had your druthers I suppose you would say we should have three CFOs; each organisation should have a CFO?

**Mr PAINE** - Yes.

**Mr HIDDING** - Because that's normal corporate structure?



**Mr PAINE** - Not essentially because of that. It is just that the issues that we face are such that the workload demands it.

**Mr HIDDING** - Does that also apply to the Chief Information Officer and the Executive Manager of Human Resources?

**Mr HAMPTON** - I don't think it does apply to the same extent.

**Mr HIDDING** - There are synergies here that the current structure does provide.

**Mr PAINE** - Correct. We have a common corporate secretary between the four companies instead of having to have one.

**Mr HIDDING** - Mr Paine, is your background engineering or finance?

**Mr PAINE** - Engineering.

**Mr HIDDING** - That is interesting. I would be interested in your views. Where did you come from before this?

**Mr PAINE** - I spent a long time in the water industry in Queensland, six years as CEO of Westernport Water.

**Mr HIDDING** - That is exactly what I am looking for. I am hoping for a frank input from you to this panel of parliamentarians who represent the community. Essentially, what happened here in Tasmania in setting up these three water corporations is that a chain of businesses, let us call them a group of 12 restaurants, were brought together under one banner. Somebody bought them and put them all together, and then they brought in a chief executive and they said, 'Mike, there's your 12 restaurants. Go and turn them into a world-beating chain and get the synergies and get it all happening - make it happen'. Anybody can see that and say it is not a bad management task. What was the shape of the business that you took over? Once you had walked in, satisfied all the background - and forget all the politics of it - what was the shape of the business that you took over? What was the culture of it, how did it really look, did they have 12 different ovens? How big a shoe box of parts was this business? Was it worse than you thought?

**Mr PAINE** - There are many issues there. We clearly articulated in our submission that it was not good. The level of knowledge around our assets was poor. The level of systems on all fronts, as I would describe it from my experience, was poor. The performance of infrastructure - poor; standards - poor. People were wanting to do well - absolute latent enthusiasm from people to want to be and do well.

**Mr HIDDING** - And knew there was scope to do well and things could be better?

**Mr PAINE** - Yes, absolutely.

**Mr HIDDING** - What about positioning of assets and major plants and things like that?

**Mr PAINE** - We talked in our submission about our burst and choke history here and both exceed the national averages by substantial margins.

**Mr MORRIS** - And both growing well?

**Mr PAINE** - We are not going backwards, that is for sure, which is where you want them to be. Normal sorts of planning instruments holistically are not there. What do I mean by that? It is what we are going to do with general infrastructure planning and the like; I would suggest that that would be how I would rate that. There were 12 different ovens, yes; everyone did things differently - not extremely differently, but differently. There is a lot of duplication in services and infrastructure that we are trying to unwind at the moment. The ability to lift the boundaries provides us with a huge amount of opportunity to go forward. The board of Southern Water has adopted a solution for the Taroona wastewater treatment plant which is \$3 million out of \$8 million, so 33 per cent or more cheaper than fixing that plant up. They are the sorts of opportunities that we are trying to plan into the future.

We have situations where there is a creek or a boundary that is a road and there will be two trunk sewers down either side of it. One goes to a treatment plant and one pumps the sewage over the other side of the hill even though the treatment plant is right at the end of the road or creek. There is a whole series of innate and inherited inefficiencies that we have in that space.

There were 13 different industrial agreements so there were 13 different ovens. We have just managed to put the pot back into shape, so we have one industrial agreement. Staff effectively doing the same job across that road were paid different rates. There is enormous opportunity to deliver what the reforms actually envisaged.

**Mr HIDDING** - I think that is a very honest and useful précis. It is good that we had an engineer to give us that.

**Mr PAINE** - One example is the wastewater treatment plant performance against the majority of what I consider to be non-contemporary permit conditions. It is poor. If we were to put on a page Southern Water's treatment plant performance and the performance of Sydney, Newcastle, Melbourne or anywhere in Victoria, Adelaide, Western Australia, Brisbane, they would all be running at 99.99 and better and we are in the 30s to 40s.

**Mr HIDDING** - Efficiency being what?

**Mr PAINE** - Compliance with non-contemporary licences in the main. There are some contemporary licences; for example Selfs Point generally does pretty well, though it is not good. That is the clearest example I can give you.

**Mr HIDDING** - There is one political environment which drove a lot of this talk in the first place. That was the southern beaches and you have inherited it. It is just the way it is. It is one of those intractable 'Oh my goodness we need to do something about water and sewerage' things and it probably started the whole shebang. The council was told no, don't even think about borrowing money. You can put together a scheme so we can send another group of engineers in for some sort of minimalist project. All these shacks that used to be shacks have turned into dwellings, and grey water is running across beaches and all that stuff. A good corporation or good organisation can be judged by how it attacks the hard things. What is your plan for southern beaches?

**Mr PAINE** - They are on our list. We fully understand that they are part of the reforms. The board will sign off on the solution for Lauderdale. In the absence of a whole range of things it actually sets a good example of how we are going to extend services into those areas.

**Mr HIDDING** - It has some synergies southern beaches.

**Mr PAINE** - Yes. It will show how we will approach that. It is due to go to the March board meeting quarter.

**Mr HAMPTON** - As you are well aware I was chair of Hobart Water before this merger or this consolidation of activity happened. At the time when I was chair I was dealing with that lovely pure substance called nice clean Tasmanian water and I was personally challenged as to the reason for the reform. It did not take me very long sitting on the tables of the three operating entities to realise that there were indeed issues. I was coming from a nice space before but had a much more challenging space now. I have met over the two years and more recently a good number of representatives from the various councils across the State, including the south, and almost without exception they largely have the view that what they had was working okay.

**Mr HIDDING** - They still tell us that now.

**Mr HAMPTON** - We know you have problems but, without being too unkind, they were not in our backyard and our solutions were the right solutions.

**Mr MORRIS** - For us.

**Mr HAMPTON** - For us, and that is the space we have inherited - as well as the pricing space. Remember, when we started, as Mike said, there were 12 councils but no single billing system. We went live and we did not have a billing system. On the first of this month our new billing system was up and running. We are embarrassed with all the issues that we had there - putting out bills for \$200 million, hitting 200 000 households and residential customers when we didn't have a designed billing system. We had all these situations - and Mike answered the question around the engineering base - but our primary interface with our customers is the actual bill. As we get the breaks and leakages down, which we will, our primary interface is the bill and we started off without a billing system. I think under the circumstances our team has done okay. There have been a few things that haven't gone as we would have liked but, under the circumstances, our accounts at the end of last year were audited and signed off by the Auditor-General. One of our greatest weaknesses - and it wasn't the councils - was that we started without a billing system. We didn't have enough time to put one in place so an arrangement was cobbled together with our council owners and various service providers to try to get there. It has been an embarrassment but it is our primary interface with our customers, which is why we have to get it right. In that sense, in terms of taking the community with us, every time we send out a bill that has something wrong on it, however minor, we erode our customers' confidence in us.

**CHAIR** - We have a number of councils that have made submissions, almost every council has made a submission. On the issue of water meters in the south, Hobart City Council

has taken a strong position, and a public position. What is your view? What would you like to inform this committee of in regard to water meters? I think one of the pressing issues has been what the cost may be and you might satisfy some of the concerns with residential customers?

**Mr HAMPTON** - The legislation requires us to have equitable two-part prices. The owners' shareholder letter of expectation to us - and the three of them are reasonably parallel in this, but the south is very clear - requires us to implement initiatives to achieve water conservation, to identify and minimise leakages and to facilitate demand management.

**Mr MORRIS** - And Hobart City Council signed that?

**Mr HAMPTON** - Hobart City Council signed that. There is the legislation and we are sitting here and we can't achieve one of them, let alone the two of them. The Government and the owners gave us a clear prescription. A significant part of the south is already metered, so are we going to leave part of it unmetered and part of it metered? No-one has addressed that question: do we pull out the meters from the 25 per cent of homes in the south?

**Mr PAINE** - It is 25 per cent. If you walk down the street outside here you see these nice shiny lids that say 'water meter'. They are all through the town, they are everywhere.

**Mr HAMPTON** - That's where we started. The board then said, 'That's what we're told we have to do. Let's look at a proper cost-benefit analysis'. All the ones that had been done previously, where people have taken positions that they didn't stack up, we looked at them. We engaged a third party to review our numbers and calculations. It was an iterative process; it happened over many months as our data improved, because we started with very limited data. We finally landed on a position that we went public with, with a presentation to our owner councils and they were all invited, then to a media release and a public event to which anyone could have come, where we presented the business case. The business case clearly indicates that on at-worst set of assumptions it's neutral to the corporation and on an at-best set of assumptions it's significantly positive. When I say the 'corporation', effectively that means that the benefits to the corporation from the introduction of meters will offset the cost of having meters and on that basis we have resolved to proceed.

**Mr MORRIS** - Can I follow that line and talk about the pricing mechanism that might well be set for water. I have here the capital cities water prices as at 1 July 2010. We find that Adelaide, Brisbane, Canberra, Melbourne and Perth all have a mechanism whereby a relatively small amount of water, either per day or per annum, is available at quite a low cost - so a basic amount at quite a low cost. Once you go over that amount then the cost per litre or per megalitre increases. Sydney and Darwin have just a flat price, no matter what. Obviously the former is intended to drive water conservation, minimise the cost for those who use very little water but they recover more from those who choose to use over and above the minimum. Is that the way that we are likely to go? Do you have a view on which way we would go here in Tasmania at the moment?

**Mr HAMPTON** - If your question is whether we are looking at a base volume that people will get effectively at no charge -

**Mr MORRIS** - No - at low charge, not no charge. Well, it's an option, but no charge would mean a very low charge. I mean at a lesser cost than a greater amount.

**Mr PAINE** - The cities and towns that you describe as being in that process were severely impacted by the drought hence the reason for moving towards an inclining block. That's probably not the scenario here - they are very difficult to explain, they are very hard for customers to understand. Administratively, they are some issues. We are not constrained in that sense of drought at this stage so then inequities develop between commercial and industrials and residential as well. There are a number of other factors in play in deciding which model you want to go forward with. At this stage we are not considering an inclining block.

**Mr MORRIS** - So that would mean you would just have a flat charge for all water as in Sydney and Darwin.

**Mr PAINE** - Yes.

**Mr MORRIS** - And Brighton currently, I believe.

**Mr PAINE** - And Geelong and -

**Mr MORRIS** - So there are two choices basically.

**Mr PAINE** - Yes. We think the task of moving to two parts is going to be substantial.

**Mr MORRIS** - Yes, that's right, but I guess even if we go to a single price at this stage there's no reason why we can't move later on.

**Mr PAINE** - Correct; as circumstances change.

**Mr MORRIS** - Your billing system will allow for that if that's the decision. I notice also from that, that they have fixed charges that vary annually between, I think it's about \$140 and \$200. This is just for water so we're not talking about the sewerage component. Does that sound about the ball park or not for where we are thinking of heading in terms of Tasmania or is that too low? Do we have any sense of that?

**Mr PAINE** - I think you've pointed to the numbers out of where there is metering at the moment and they're at \$190-something for the fixed fee, so I can't see why we would be thinking that it's much different to that. Obviously, the fixed charges for water are exactly that and a pipe is a pipe no matter where it is, effectively.

**Mr MORRIS** - The issue, though, is that your capital works program primarily relates to the fixed costs so the pumping cost basically won't change - you're expecting to make a saving but what if you actually may be spending less on pumping water. It's that fixed charge around the capital costs that's going to be the key issue. If we were to ignore for a moment the \$500 million backlog that Southern Water is faced with, it would seem that around about \$200 a year fixed charge and anything around about \$1 a kilolitre for supply charge would see the corporation have enough money to run it a reasonable way. It is this big backlog that is going to be attached to the fixed charge that is going to be the problem, isn't it?

**Mr PAINE** - The majority of the backlogs are in the wastewater section of our business. The water infrastructure is the replacement issue so it is already -

**Mr MORRIS** - Okay, so it is all factored in so it is not the water component that we are really focusing on here in terms of the actual work you have to do.

**Mr PAINE** - Yes, that is right.

**Mr HAMPTON** - It will come through in the fixed charges for sewerage.

**Mr MORRIS** - The water supply side is not too difficult if it is treated in isolation, it is the sewerage component. If, again hypothetically, that backlog did not exist and you were to set a sewerage removal charge of \$450 or \$500 or whatever it was going to be, have you thought about whether we might, because we have this backlog to clear, apply that as a surcharge - treat it separately, isolate it from the run-of-the-mill situation and treat it as a surcharge so that people can identify, the whole community can see, this is the backlog we have to deal with and it relates clearly to those identified projects out there, the magical \$1 billion statewide that Michael Aird often quoted?

**Mr HAMPTON** - I am not aware that we have considered that.

**Mr MORRIS** - Because then presumably, once you have caught up, it can drop away and it does not need to be there any longer.

**Mr HAMPTON** - We would still be having to look after -

**Mr MORRIS** - Yes, that is your core business that underlies it all and that has to be factored in.

**Mr PAINE** - Depreciation and interest on those things would still be part of it forever.

**Mr BEST** - Mike, do you see, because you did mention the matter of efficiencies moving forward, the backlog as we have just heard and other things that are occurring, that this organisation will perhaps reduce costs in some way? I do not know how that might eventuate but it could do just in the way that you are managing things as opposed to what was it, 12 or 13 different arrangements?

**Mr PAINE** - Absolutely.

**Mr BEST** - Are there things like, for example, standardising of equipment? Do you see all these things coming together into the future efficiency-wise?

**Mr PAINE** - Absolutely, and that is our focus. If you think about it, we have adopted a set of asset standards that will apply across the whole of our region. We are going to have single sets of systems rather than multiple sets of automation systems, for example. I think we have six or eight different telemetry systems so we have one licensing and it is then wrapped up into one. There are a number of those easy wins and we are on the way to that but the bigger wins are in operating as a bigger business across a bigger area and that is part of our focus now as well.

**Mr MORRIS** - I have had an approach from the Derwent Valley in relation to one area. They do not have water or sewerage at the moment but what they would like is a water supply. They are larger blocks. The water infrastructure is at Lachlan so it is near the old reservoir, which you would be well aware of, so there is piping basically out there. Obviously their area is not going to be on the radar for the infrastructure upgrades that you currently have so what will be the process for any community or group of individuals who want to see an extension to an existing water scheme?

**Mr HAMPTON** - We have an active process of engaging with our council owners in that regard so we do receive input as to what the community is saying they would like us to explore. At the same time we have a priority task list largely set by discussion with the environmental and health regulators as to which we had to tackle. Clearly we can juggle that order and sometimes we might choose to bring something that is well down the list forward because it is economical with other things that we are doing.

**Mr MORRIS** - Sure.

**Mr HAMPTON** - So it is not entirely in our domain. I suppose you could say that we can just decide but at the end of the day we have a compliance issue and across the State we are struggling to varying degrees to get the various contractors and people who we need to do things that we would like to do in the time frame that we would like to do them. We are encouraging the community through councils to talk with us about what they consider is appropriate in particular regions and then to try to bring that into our planning and then balance that with the other constraints that are put upon us, particularly the regulatory constraints.

**Mr MORRIS** - Sure. Do we engage directly with Southern Water as a community or do we do it through our council?

**Mr HAMPTON** - We at Southern Water are happy for direct engagement. We cannot say that we can necessarily respond but we are happy to have the engagement.

**Mr MORRIS** - Great. It is the discussion they are after, that's all.

**Mr PAINE** - Absolutely.

**Mr MORRIS** - Fantastic. Thank you.

**CHAIR** - On behalf of the committee, thank you very much for your time this morning. Could you provide to the committee the priority list for your capex moving forward and the projects that you are looking at?

**Mr PAINE** - Absolutely.

**CHAIR** - If that can be sent to Charles, that would be great.

**Mr PAINE** - We have the re-balancing and the dividends we paid for 2009-10. We will forward that to Charles.

**CHAIR** - Perfect. Thank you very much for your time, we appreciate it, and we appreciate the frank way that you have approached it.

**THE WITNESSES WITHDREW.**



**Mr ROB VALENTINE**, LORD MAYOR, AND **Mr NICK HEATH**, GENERAL MANAGER, HOBART CITY COUNCIL, WERE CALLED, MADE THE STATUTORY DECLARATION AND WERE EXAMINED.

**CHAIR** - Gentlemen, thank you very much for coming today. We have all received your submission and had a look at it; it is comprehensive. We will give you the opportunity to talk to it.

**Mr VALENTINE** - Can I provide to you a copy of the main issues that we are bringing to the table today? They are my briefing notes but they do serve as a good summation of what the issues are. I will say right from the outset that we're not here to talk about water meters; that's not something that we are here to deal with. We are happy to make a comment on it personally, but we are here to put before you these five particular matters. Firstly, we advocate that the water and sewerage corporations remain as local government regionally-owned corporations. I think that is an important status to have. Without reading through it all, the major concern of the council if the State Government was to take over the water and sewerage corporations is that it could presumably do so either with or without compensation to local government. You will appreciate that our input into this whole process originally was around about \$450 million in assets. That has been revalued, and I say revalued down, to about \$197 million - which we will get to at a later stage. We have a significant interest, given that our municipality has generated that level of infrastructure.

**Mr HEATH** - I suppose it is around 30 to 40 per cent of the region's total infrastructure of \$1.2 billion, so it's a significant amount.

**Mr VALENTINE** - We see that there's little or no apparent benefit to the community from the creation of a statewide entity or for a change in ownership from local to State government. While there could be one CEO instead of three, the three-region pattern of independent supply systems would require there to be regional offices and management structures, so there would be very little to be gained. I think it is seen that they are indeed three entities at the moment and they operate in their own particular ways, which might militate against bringing them together and trying to get efficiencies out of a single corporation. Each system would still need a tailored management approach based on local knowledge and familiarity. Indeed, the imposition of unnecessary overarching levels of management on such systems can hinder their efficient management rather than facilitate it. There is little or no interdependency between the regions in the supply of these services, unlike electricity or gas where there is a high interdependency. Our recommendation on that first point is that the water and sewerage corporations remain local government regionally-owned corporations.

One of the major problems for us is the relationship between the owner councils and the boards of the regional corporations. Basically the reform process established a consultative group of owners' representatives, which you are obviously aware of. Three owners' representatives were appointed from each of the regions, making nine in total. Under the Water and Sewerage Corporations Act 2008 it specifies the role of the owners' representatives, and that is detailed in our briefing notes. Since the reforms began there has been a significant lack of appreciation of the interrelationship between remaining

council functions and water and sewerage activities. It is not insignificant. Councils require good, strong relationships with the water and sewerage corporations at the policy and operational levels in respect to their responsibilities in the areas of roads, drainage, land use planning, economic development and all of those things. The role of the owners' representatives is not clear in the legislation and they are not truly representative of the shareholders. Arrangements with the owners' representatives are becoming more and more difficult as councils increasingly seek to have a direct contact with both the board and the management. What you then get is a bypassing of the formal representatives process. Reporting to the owners' representatives when councils want a direct line of communication places the corporation in a difficult position, so you can understand that there are some complexities with the way we do our day-to-day business and need to communicate with those corporations.

I said before about the level of equity that we have. In total, Southern Water has an asset base of \$1.1 billion, greater than the asset base of the other two regional corporations combined, and services almost the combined population of the other two regions, so we are talking about a very significant asset base. The owners' representation is not equitable, though, and that's the thing that we are concerned about in respect to either the business size or the population served across the State. In Hobart's case, the council contributed assets of a written-down value of \$197 million, representing 22 per cent of the overall value of the business, but it has no direct say in how Southern Water operates. It is just not a reasonable position for our council to be in, having put so many assets into that.

**Mr MORRIS** - Can you give me an example of what sort of things Hobart Council would like to presumably direct Southern Water to do, rather than go through this possibly circuitous route that is currently required?

**Mr VALENTINE** - I think we have an example right in front of us at the moment when it comes to water meters, but I don't really want to get into that. We see that it is socially regressive to go down the water meter line.

**Mr HIDDING** - Who sees that - the council?

**Mr VALENTINE** - Council sees it as a socially regressive thing but we are not putting forward a position, as council, on water meters and we have not done that at this point of time.

**Mr MORRIS** - Oh, haven't you?

**Mr VALENTINE** - No.

**Mr MORRIS** - Right, I must have missed something.

**Mr HIDDING** - Because it's in the legislation?

**Mr VALENTINE** - No, it's not in the legislation; two-part pricing is in the legislation. That's the thing; it's not in the legislation. You could say, 'How else are you going to get two-part pricing? - well, there's the question. The way it is being put forward at the moment, if you want a personal opinion on that, is that you have an infrastructure charge

and you have a volumetric charge. If you use 10 000 litres of water per annum, which is probably vastly under what you would use but for the sake of the argument, and I use 50 000 litres of water, why are we both paying the same infrastructure charge? It is not right.

**Mr MORRIS** - Because you are using the same amount of infrastructure.

**Mr VALENTINE** - No, you're not because you're wearing out the infrastructure more if you are putting 50 000 litres of water through it. You are causing more employment, you are taking more dosing; the wear and tear is not equitable.

**Mr MORRIS** - But that's in your water charge.

**Mr VALENTINE** - That is why it is not equitable; it is not an equitable system. If you want a fair system, that's not equitable.

**Mr MORRIS** - You believe the current system is?

**Mr VALENTINE** - The infrastructure charge should be directly related to the amount of water you use. So if you are only using two litres of water a year - let's take the sublime to the ridiculous - why should you pay the same infrastructure charge as somebody who is using a million litres.

**Mr MORRIS** - So you are suggesting that the AAV system does precisely what you are suggesting?

**Mr VALENTINE** - No, what I am saying to you is that it is no different to the AAV system. You are gaining no advantage by going to a two-part pricing system in this way. You are complying with the act but you are not gaining an advantage when it comes to social equity, and that's the problem. It's the social equity; it's a user-pay principle. We don't do it through our income tax system, we don't do it through the way we charge people for hospital use, so why are we doing it for this?

**Mr HIDDING** - We charge taxes rather than a rate; this is a rate we are talking about.

**Mr VALENTINE** - It is a tax, let's face it.

**Mr MORRIS** - Should we have a zero fixed charge and a fully volumetric charge?

**Mr VALENTINE** - No, I think the volumetric charge needs to inform the infrastructure charge. There are still two parts and you can still do it under the act. That is a personal opinion and we are not here to push that.

**Mr HEATH** - Getting away from meters but giving another example of where we feel frustrated as a shareholder, normally shareholders in a BHP or Myer meeting, something like that, would have a direct say over the appointment and remuneration of directors. We clearly don't have that. To do that there is a selection panel process set up under legislation but the council, as owners and majority shareholders, do not get a say in how the directors are appointed, how they are remunerated, what their terms and conditions of appointment are. As a shareholder that is a reasonable expectation that we should have a

direct say in that, rather than go through a selection panel process which is then referred to the owners' reps - that sort of thing. I think the shareholders should have a direct say.

**Mr MORRIS** - That's the point where you want to have influence on the corporations?

**Mr HEATH** - That is an example.

**Mr MORRIS** - It is not about directing their works program.

**Mr HEATH** - Absolutely not.

**Mr MORRIS** - That's their judgment on what needs to be done when.

**CHAIR** - Have you had discussions with the chairman or the corporations about this?

**Mr VALENTINE** - Yes, we have.

**Mr HEATH** - The chairman and the corporations are bound by the legislation. I suppose we are here making submissions as to how that legislation may be improved.

**CHAIR** - I wish you had been here for the previous presentation.

**Mr HEATH** - I have; we colluded before we came.

*Laughter.*

**Mr HEATH** - No, we haven't.

**Mr VALENTINE** - We have actually talked with them and they've come along and presented to us. Take the role of the Treasurer, for instance, in his or her own right and whoever it happens to be on the day. As the conduit for the Parliament, they play a role in a broad range of areas, including changing the constitution of the corporation, dictating to the corporation the form of the corporate plan, approving and/or amending corporate plans, requiring notification of the appointment of owners' reps, dictating the number of additional directors of a common services corporation - I could go through the rest. That's the Treasurer and yet we are the owners.

**CHAIR** - We accept the point you're making.

**Mr VALENTINE** - To answer in part, it's that stuff and it's governance. It's simply not the right governance structure as it exists at the moment.

**Mr MORRIS** - Happy to take that on board.

**Mr VALENTINE** - Our recommendation on that particular matter is that the consultation group, the owners' reps, be abolished and that normal provision for a shareholder consultation under Corporations Law be adopted where all shareholders are represented individually. That's basically on the same lines as the old Hobart Water used to operate. It means that every council has an input and a direct degree of access to management rather than through, in our case, one vote out of three - or nine if it's statewide.

**Mr HEATH** - It's not about telling Southern Water they should put that water main in or they should take that one out.

**Mr VALENTINE** - No.

**Mr HEATH** - It's a governance issue.

**CHAIR** - In regards to governance and an equitable make-up of any board, are you suggesting one representative per council or that the number of representatives a council may have might be based on their asset value?

**Mr VALENTINE** - We didn't necessarily do it that way in the first instance with Hobart Water.

**Mr HEATH** - That is our primary submission, that we do away with the owners' reps and have a direct say. I would have thought one-for-one is fair but the council hasn't got a position on that.

**Mr VALENTINE** - No, whether it's population or otherwise. It's better than it is now - put it that way.

**Mr BEST** - I can understand where you're coming from but to be fair why isn't it appropriate that there would be some level of involvement along those lines? It doesn't necessarily mean the Treasurer is going to come down and tell the organisation exactly what to do. Why wouldn't they have input on some of those matters?

**Mr VALENTINE** - Because they don't own the corporations. Why should they? It's not their corporation.

**Mr BACON** - If the purpose of the reform was to make up the under-investment in infrastructure, and the Government has taken a guiding role in that, then surely the Treasurer would have an interest to make sure that actually happens.

**Mr VALENTINE** - But this is the point. It was sold to us as local government being in control and yet we're going down a line where there's a fourth corporation all of a sudden coming in as Onstream. We have no option as to whether we use it or whether we don't. This is not just about achieving the Government's objective of fixing the problems that are out there on the coast.

**Mr HEATH** - The Treasurer has a say at the moment in the corporate plan but the Treasurer can't veto the corporate plan. I think the Treasurer having a say in the corporate plan is probably fairly reasonable - to have an oversight - but why does the Treasurer have to be notified of the appointment of the owners' reps? Why does the Treasurer have to get details of the governance arrangements that are put in place by the shareholders and the company? I don't have a problem with an oversight role, as you're suggesting - I think that's sensible - but it's not the role of Treasurer to get embroiled in the details around the appointment of owners' reps and selection panels and that sort of stuff. I don't see it.

**Mr VALENTINE** - It's sensible in terms of wanting it to meet a certain objective, but not to control it.

**Mr HEATH** - For instance, why does the Treasurer have to approve the shareholders' letter of expectation? If the shareholders are happy as a group and it's signed off by the company, what role does the Treasurer have?

**Mr BEST** - What happens if something falls over? Would there be an expectation that the State Government would help sort it out?

**Mr VALENTINE** - You are talking about corporations that have existed since 1852 - local government. They are not kindergarten kids; they have been in the business a long time.

**Mr BEST** - I have seen it in my lifetime up in my electorate.

**Mr VALENTINE** - It is there.

**Mr BEST** - I am just saying to you -

**Mr VALENTINE** - I cannot speak for your electorate.

**Mr BEST** - No, but I can so that is why I am asking the question.

**Mr VALENTINE** - The Hobart Water was formed to take over the Metropolitan Water Board, which was a government-run corporation, and they passed it across to us with a \$60 million debt and it went into this new structure 10 years later with no greater debt. We have been running it and running it efficiently and effectively for that period of time and if it was going to fall over it would have fallen over before today under Hobart Water and it has not. I just do not think that is a realistic situation to be quite honest.

**Mr BEST** - Sure. We have heard from Southern Water though that there is quite an amount of infrastructure that needs to be caught up with - I do not know where that is exactly but -

**Mr VALENTINE** - It is true.

**Mr BEST** - Do you know what I mean?

**Mr VALENTINE** - I do not deny that at all, but there are ways of doing that.

**Mr BEST** - You are proposing a different method?

**Mr VALENTINE** - A different proposal, a different method of fixing those problems. Hobart Water was attending to the Glamorgan-Spring Bay issues before and the southern beaches prior to being taken into this new model. It was actually attending to those and it was doing it in a reasonable manner. You can do it through loans. They have the asset base to be able to borrow against that - they have not proven themselves to be bad managers. It used to be management of water; our model would have expanded their horizons to take in sewerage component; they were doing it anyway and we could have done that without all this disruption. We have it now, we understand it is here and we

are not saying throw the lot away, we are just saying it needs to have a different governance structure to be able to meet the objectives of not only the Government but also local government.

The next point is the removal of the common directors and the selection panel process. Well, it has been touched on a little bit. There is an inherent conflict of interest that way this is set up with regard to the common directors. How can you sit on a statewide body as a director and sit on a regional body as a director and serve the best interests of both? You cannot do that and there is an inherent conflict of interest in that. You do not have to be Einstein to see that it just simply does not fit anyone's reasonable model of corporation governance.

**Mr HEATH** - We might concede that there might have been a need for common directors when the thing was first set up but I think that time may well have passed. So the conflict of interest issues, the volume of work that the common directors have to undertake as well, how can they possibly be across all issues when the volume of work is there. So we would concede it was probably necessary in the first instance setting the thing up. It has now been going 18 months and we think the need has passed.

**Mr MORRIS** - Do you think it is possible that it might be a phase-out period for common directors so that we reduce them by one each year or two years - maybe the time has not quite passed, for example, maybe there is still that need for a common thread between them?

**Mr HEATH** - Our primary submission is that they should go. We have not directed our mind to whether it should be phased out. There are some pros and cons in that as well but I think we would like to see them phased out by a certain point in time. But I can understand the arguments from the point of view of continuity and that sort of thing but at the end of the day there is no overriding reason why they should remain.

**Mr VALENTINE** - You can put a reporting conduit in there to fully inform the whole structure without actually having the common directors.

**CHAIR** - There would be a mechanism.

**Mr VALENTINE** - So there is are recommendations there: reduce the duplication of effort by abolishing the systemic and inherent conflict of interest which I really think is an issue now more particularly; ensure the interests of each region are dealt with with appropriate rigour; remove the selection committee process; and allow the shareholders to have a direct say in the appointment of the chairperson.

It comes down to the common services corporation - Onstream - and I guess I touched on that a little bit. There is no fair competition now. There is this fourth corporation and the regions are bound to use it and there is no competition there. If they feel they are getting a raw deal, if they feel that they are not having their bills sent out in a timely manner and they want to get a better system in place they are bound to Onstream and that is not reasonable; there is no competition. We want to see that the regional corporations do not have to use Onstream as a compulsory thing.

**CHAIR** - What is your view of the appropriate model then from Onstream?

**Mr HEATH** - We think Onstream should stay but we just don't think the compulsion should be made - in other words, if the corporations wanted to buy their IT services from ABC Pty Ltd why should they be constrained by legislation not to do so? It is an inbuilt cost. They may want to do their own services in-house and why shouldn't they?

**CHAIR** - Can you see benefits in their remaining a corporation or could the three corporations perhaps manage the circle of the services that Onstream provide to be provided through some form of joint venture arrangement between them?

**Mr HEATH** - In fairness I think you need to ask the corporations that question. From a governance point of view, though, we don't see the need for a compulsion or a prescription that Onstream has to be used for those particular services. Free it up so that the corporations can make their own business commercial decisions rather than being constrained by the legislation that exists now.

**Mr VALENTINE** - It might be that there are better gains to be made if one of the larger councils that already has structures in place could be used to send out bills or something.

**CHAIR** - That was exactly the question - do you think that there are services that could be provided by -

**Mr VALENTINE** - Absolutely, and there would be a number of councils that would probably put their hand up and say that they have this or that and you go through a tendering process virtually. At least the corporations could ask for expressions of interest in how they might deliver a certain service and then the reps vote accordingly. They make sensible, reasonable decisions. This fourth corporation is not something that local government wanted, it came in as part of the legislation. I can understand that there might have been some notion that it would create efficiencies but it is not proving to be that way.

The last point which we make is privatisation. We are restating our commitment to no privatisation of Southern Water as enshrined in the Water and Sewerage Corporations Act 2008. We would hate to see this whole area of operation being privatised. I do not think it would benefit anybody. It should be a service governed by the people for the people and at this particular point in time I don't think it is being fairly governed to allow that to be done efficiently and effectively. There are better ways of delivering this service than under the present governance structure.

Obviously pricing is an issue. The opportunity for manipulating pricing must be taken out of the hands of the Treasurer and the independent regulator should be given responsibility for pricing. I mean, it should be an independent regulator if there are going to be any pricing issues. It should not be something that the Treasurer becomes involved in. The independent regulator is going to look at things like, one would hope, social equity and the likeability of pay, all of those things. I have some personal opinions about this user-pays scenario, as I have already said. We don't want to go down that line as a community, I don't think. We want to be a community that is sensitive to people's capacity to pay and I just don't think this whole structure enables us to be able to move in a direction that we feel is of benefit to our people at the end of the day.



**CHAIR** - One of the key drivers of price is the move toward a 7 per cent return -

**Mr VALENTINE** - Sorry, move towards?

**CHAIR** - The weighted average cost of capital, the return of 7 per cent in all of the modelling that has been conducted and that obviously has a flow-through in regard to when the corporations can invest in the projects that they need to invest in but also in regard to the returns to the owners. In fact, that is probably one of the key determinants. We have heard this morning that if all current settings remain the same there would be an expectation that over a 10-year period there would be need to be a compounding 10 per cent per annum increase in price, therefore a doubling in the price to customers in around seven years' time - obviously significantly more over the 10-year period. As an owner, where do you see that changes could be made or ground could be given to ensure that those price shocks aren't foisted on customers?

**Mr VALENTINE** - At the moment the way the caps has gone it hasn't helped.

**Mr HEATH** - There needs to be a considered way to get that cap off. We are saying that some of the governance changes that we are proposing will save the corporations some money. The fact that they can go to the market and choose what services they want to provide - as I said before, they're not prescribed as to who they are - there is an opportunity to save on directors' fees and costs as well. Our council particularly wanted to have a say in the capital works program, as to how it was set up - not to direct on an individual basis which pipe goes in, but we wanted to have a bit of a look at the capital works program to provide some advice on that, and that wasn't accepted either. There are ways where as a shareholder we can have a say but I think these governance structures are something you need to look at because that will help save the costs. The cost of operating the business is not cheap.

**Mr VALENTINE** - I guess you're talking about the Government's vision to fix those problems again. They need 7 per cent over that period to get the money in and I think statewide they're talking about \$1 billion worth of assets, or some such thing. That is an ideal but I don't think we can go past the social equity issue problems that that particular model is going to cause. I honestly think that there must be a better way of being able to get the gains and that investment coming back than the pricing structure that is currently in place. I honestly think from our municipalities' point of view, and the people in our municipality have already paid for their infrastructure to the tune of \$450 million and seen it devalued down to \$197 million so that the corporations can continue to operate, and now having to pay to get that 7 per cent for what is happening out on the coast. It is not an equitable way forward. I think there could have been a different model in place which at least, through effective lobbying and the like, may have seen some grants coming in from Federal government to fix the problems on the coast, more so than causing grief across the whole region. It is 5 per cent of the people; 26 towns but 5 per cent of the people.

**Mr MORRIS** - We have heard from Southern Water today that it is not the water supply situation that's the cost problem, it's the sewerage compliance that's the cost problem so far as they're seeing it.

**Mr VALENTINE** - That's true, too, but that has its hidden issues. I can give you a classic example. I have an envirocycle loo down at my property and if the water pipe goes past my property I'll be forced to put in a sewerage system. That's creating demand, that's not saving water.

**Mr MORRIS** - I think you're safe for a while yet.

*Laughter.*

**Mr VALENTINE** - But you see what I mean?

**Mr MORRIS** - Yes. For example, there is the Taroona treatment plan, which has been cited a number of times, and the replacement cost of that has been estimated at \$8 million, whereas an alternative system - and I'm not sure where they are intending to pipe it to; it's either across the river or back up to Self's Point - is a \$3 million project. That will achieve the compliance -

**Mr VALENTINE** - Again, it's the way you get that money. It's the pricing model you are using to get the money and balancing that with the social-equity issues. I think the way it is charging at the moment is not a fairer system, which is what's being touted.

**Mr MORRIS** - I would like to follow through on that, if I can. Your expectations around profit - the corporations said that they basically came in with a \$20 million profit this year out of \$110 million of income, of which the priority of dividends were handed out first - I don't know whether you receive a priority dividend?

**Mr VALENTINE** - We do, but we didn't get what we were expecting. It was about \$400 000 less, in \$2.1 million - we got \$1.7 million.

**Mr MORRIS** - Surely, a \$20 million profit out of \$110 million of income is a significant profit; there is no doubt about it. If that profit is going to be maintained in percentage terms as the income needs to rise with the corporations, is the council prepared to accept a lower rate of return, because at least 20 per cent of the cost increases are directly profits that are going to go back to the council?

**Mr VALENTINE** - I can't give you that answer.

**Mr MORRIS** - Are you prepared to talk about it?

**Mr VALENTINE** - Of course the council will talk about it but again it comes back to the issue that if you're putting in a commitment then you expect to get a return so that you can put money back into your own programs, for the true value of that infrastructure rather than some devalued amount for the sake of operation. We've taken a severe hit here. We weren't making a profit of 7 per cent; we were making a profit of 2.5 per cent.

**Mr MORRIS** - So you got a windfall, didn't you?

**Mr VALENTINE** - We were maintaining our assets. Contrary to popular opinion, the sewage in Salamanca Place was a stormwater issue; it had nothing to do with sewerage.

**Mr MORRIS** - Back to the issue of charging. If you're not happy with the idea of moving to a standard two-part pricing model, can you provide a submission to this committee on what you think would be an appropriate model for pricing for the southern area to move to?

**Mr HEATH** - We are not saying we don't agree with two-part pricing.

**Mr MORRIS** - No, sorry, the current model - which is a fixed charge and consumption charge with a postage stamp basis.

**Mr HEATH** - The council has asked for a report on what alternatives there are within the law, within the two-part pricing regime. We are currently getting some advice on that. We're very happy to provide that, subject to council approval, of course.

**Mr MORRIS** - So you support two-part pricing but you just don't think that the fixed charge -

**Mr VALENTINE** - We signed off on it on the corporate plan.

**Mr MORRIS** - Yes, that's right.

**Mr VALENTINE** - We did sign off on two-part pricing but we didn't sign off on this particular model.

**Mr MORRIS** - Okay. If you could perhaps suggest a better model to us we would be very keen to hear it.

**Mr HEATH** - Council has asked for advice on other models, including thresholds, a certain amount of free water and that sort of thing. When we've done the modelling on it we'll obviously be happy to provide it to you, subject to the council agreeing to do so.

**Mr VALENTINE** - The issue of the modelling that I was putting forward was my opinion, not the council's opinion in terms of volumetric charge modifying the infrastructure charge. It didn't meet with any opposition.

*Laughter.*

**Mr VALENTINE** - We just haven't had that final debate on it and the decision made.

**CHAIR** - We understand. Thank you very much.

**THE WITNESSES WITHDREW.**

**Mrs ADRIANA TAYLOR**, MAYOR, GLENORCHY CITY COUNCIL WAS CALLED AND EXAMINED. **Mr FRANK PEARCE**, GENERAL MANAGER, GLENORCHY CITY COUNCIL, WAS CALLED, MADE THE STATUTORY DECLARATION AND WAS EXAMINED.

**Mrs TAYLOR** - We were sitting listening and a lot of the issues Hobart has are the same issues that we would have.

As it says in our submission, the need for the common services corporation is an issue for us - whether there is a need for it at all. If there is a need for it certainly we do not believe that there should be a compulsion to use it, even if it remains in the legislation. We do not actually see there is a need for it at all but certainly if it remains then we need not have compulsion to use it.

The directors' conflict of interest and the governance structure are real issues for us because we do believe that it is impossible as a member of a board, both of the common services and of each corporation, to be able to act in the best interests of that particular corporation. It clearly says in legislation that that is what directors of a company should do. I know that the directors have been excluded from Corporations Law, however that does not seem to me to be a sensible thing to do. I think the corporations ought to act as any other corporation, which is how they have been set up. The intent was to set it up as a water and sewerage corporation that would be independent, that would stand on its own feet. They would each be viable companies - one or four or three or whatever the number is - and to do that you have to have control over your own structures.

We are very concerned about the degree of power they have put in the Treasurer. Clearly the legislation actually gives the Treasurer more control over these corporations than he has over a normal GBE. The past Treasurer was at pains constantly to say that this is not a GBE and it belongs to the councils and it is their responsibility, but clearly a degree of control can be exercised, as seen by the fact that the corporations were called before the GBE hearings last year. Again, that is what is expected, what the legislation said, but they are not GBEs. So it is very much no-man's land and we think that ought to be fixed.

We believe that the owners ought to have control of the corporations; that is basically it. Mr Valentine mentioned the model that Hobart Water had before we went into regional water and sewerage corporations; that model worked very well, in our opinion. We are not asking for the water and sewer corporations legislation to be totally repealed. The fact is we now have water and sewer corporations regionally. We do not object to regional water and sewer corporations but they need to be owned and managed and controlled by the owners as viable businesses and allowed to operate as viable businesses rather than have government control.

The price cap which has come up since this was established is a serious issue. We see a huge problem arising, as everybody has said to you, I am sure, if the 5 per cent price cap continues. We would like to see it stopped, or at least phased out or re-applied, rather than carry on for the three years. The third year could be changed where the Government might still put in that 5 per cent but put it into the corporations and so

smooth out and transition it over time so that there is not a price shock when that price cap stops.

**CHAIR** - How do you think customers might react if, for example, the price cap was to be stopped this financial year or reduced over the next financial year at least? Obviously the corporations are going to have a revenue requirement.

**Mrs TAYLOR** - That is why I think the Government should continue to give that price cap and phase it out, but put it into the corporations rather than give it as a direct reduction to customers. This means customers will still benefit, just as the corporation will be more viable. Customers are not going to like the price hike at the end of the time either, and it is compounded. If you do 5 per cent a year then by the time the fourth year comes it is a huge jump.

**Mr MORRIS** - In the case of Glenorchy your ratepayers are likely to be winners in relation to the re-balancing or the postage-stamp pricing across the southern area.

**Mrs TAYLOR** - That is a different issue. Hopefully they will, yes. That is nothing to do with the price cap, though.

**Mr MORRIS** - No, it is nothing to do with the price cap. It is that you were able to have your water and sewerage business run at a profit and therefore priced appropriately, whereas I think Hobart City Council certainly didn't to the same degree that you did, it would seem from the figures provided by the regulator in his original report. I just noticed their estimate of Glenorchy ratepayers on average paying \$13.27, which is well above the \$8.70 average price that we were quoted this morning from the water corporation, so it would seem that the issue there is not going to be for your ratepayers other than the simple transition of moving from an AAV-based system to a two-part pricing basis.

**Mrs TAYLOR** - So you are talking about two-part pricing; you are not talking about the 5 per cent price cap -

**Mr MORRIS** - Not at the moment.

**Mrs TAYLOR** - because that does not touch Glenorchy at all. Because our residents were paying more we were guaranteed there would be a 5 per cent price cap anyway. The rest of the State had a 10 per cent and a couple of councils had 5 per cent -

**Mr MORRIS** - Yes, you had it anyway.

**Mrs TAYLOR** - so our people had no benefit from that because everybody else went down to where Glenorchy already was. Our 5 per cent benefit didn't go down 5 per cent, so our ratepayers lost out on that one again.

**Mr MORRIS** - I am talking particularly about transition to two-part pricing. It will actually be relatively easy within the Glenorchy area, won't it?

**Mrs TAYLOR** - Yes and no. On average, yes, but we have a significant demographic that is high and low. When you look at all those figures and water consumption and stuff in

Glenorchy you have to remember that one-third of our water consumption is used by one user. Nyrstar takes a third of the water, so when they say this is how much water is used on average by Glenorchy people, you take a third of that out and that makes a significant difference. Our water usage is not nearly as high as it looks in the scheme of things. I understand Nyrstar have in the past certainly - I don't what the figure is now - had a good deal on water. We do have a significant proportion of our population who are lower socioeconomic and for them the water and sewerage rates will go up regardless because for our commercial areas they will come down if we go to postage stamp plus consumption. All the commercial properties will benefit enormously. The higher end of our valuations will do very well. That is one of the issues certainly that we over the years have had from people who have higher value houses - waterfront housing and stuff - who say they are paying an extraordinary amount for water as it then was - water and sewerage because councils were charging it - that that was unfair and indeed that is true. However, if you look at the lower socioeconomic groupings, they will be paying more obviously. It is a shift. Yes, overall I expect that Glenorchy ratepayers will pay less but it will be on average.

**Mr MORRIS** - There will be winners and losers.

**Mrs TAYLOR** - We have something like 14 per cent of public housing in the city - a significant amount.

**Mr PEARCE** - We did a fairly detailed study back in 2001 or 2002 on the impacts of introducing two-part pricing. It indicated at that stage that there would be overall about a 12 per cent shift of the water billing from the commercial-industrial sector into residential, and then a significant shift from high-value residential to low-value residential. So the lower end might end up having a 20 per cent increase in water cost as a direct result of two-part pricing.

**Mr MORRIS** - But that goes to the landowner and not necessarily the tenant.

**Mrs TAYLOR** - We don't know where it's going to go at the moment, do we?

**Mr MORRIS** - No, we don't.

**Mrs TAYLOR** - That has not been decided.

**Mr MORRIS** - It looks like it's shifting from the tenant to the landowner.

**Mrs TAYLOR** - It would make more sense, I would think, to have it as landowner rather than occupier.

**CHAIR** - Albeit there are difficulties with the current governance structures and the way they operate, one of the key drivers to the price is obviously the 7 per cent weighted average cost of capital. The transition pricing arrangement that was first discussed, prior to the IPO but then through the IPO, to get to full cost recovery was that full cost recovery was 7 per cent or thereabouts weighted average cost of capital. That is a very healthy return. We know from our own discussions that not many, if any, water corporations around the country achieve that figure; in fact most are significantly less. If that 7 per cent weighted average cost of capital were to be reduced as an expectation or along the period of time

for that to be brought in, then obviously that would have a major impact on the revenues that were required to be generated by the corporations. The outcome of that, though, would also be an impact on owners. As a council, have you as owners modelled, looked at or considered any ways that levers might be pulled within the corporations to reduce the impact of price increases on customers and how that might impact on council over time?

**Mrs TAYLOR** - We haven't modelled.

**Mr PEARCE** - We have certainly modelled in terms of our budgeting what the impacts of the changes in water and sewerage reforms did to our capacity to provide non-water and sewerage services and we understand that very thoroughly. We don't know what particular return on investment we want out of Southern Water, but we do know that we need to maintain good dividend outcomes for us because otherwise we're going to have to put our rates up even more than we otherwise would. It seems to me that a lot of the analysis prior to introducing the water and sewerage reforms was about a billion dollars worth of investment across the State, and probably \$300 million to \$400 million of that wasn't covered by the council's forward plans but the rest was. That would account for a lot of those boil-water alerts and particular area sewerage shortfalls. I guess maybe the expectation is a little bit higher in terms of achieving those within that 10-year time frame, and that could be stretched out a little bit. Many of those boil-water alert locations probably don't particularly care that they have a boil-water alert or want to pay to change that, so do you need to spend all of that extra \$300 million to \$400 million? If you do, do you need to do it within 10 years?

**Mrs TAYLOR** - There are several things. One is the cost of the current corporations. Because of Onstream and the fact that the owners don't have control, we can see that there might be significant savings for a start. I agree with Frank that the capital works program might be stretched out a bit rather than that extra \$300 million to \$400 million all be spent in the first 10 years. Do we need to get 7 per cent in the long run? Yes, but now - no. We should look at that being phased in over time rather than increasing over time.

**Mr BEST** - A couple of years ago a heap of eels died in your water storage. What happened there?

**Mrs TAYLOR** - They didn't die in our water storage. We didn't get the full facts of that either because it was Hobart Water. As I understand there are always eels in one of our water supplies, which is Tolosa Dam. An outlet was not closed off before they started using water out of it, so the eels were sucked out of Tolosa Dam. They died in the pipes, I think, rather than being dead eels at the start.

**Mr BEST** - I was interested in that because I drank some of the water and it made me sick.

From what I understand, you're saying that in principle you agree with the regional arrangement.

**Mrs TAYLOR** - We don't have an issue with regional -

**Mr BEST** - You see the savings that are projected et cetera, so it is more about the fight over how it works out.

**Mrs TAYLOR** - Absolutely. The legislation and the structure has not been -

**Mr BEST** - Who gets what piece of the pie or whatever.

**Mrs TAYLOR** - Correct. It ought to be operating as a stand-alone corporation controlled by the owners and able to work out its own viable future.

**Mr BEST** - In terms of infrastructure, you could see improvements with the regional -

**Mrs TAYLOR** - Not for us. Glenorchy was managing its own water and sewerage pretty well.

**Mr HIDDING** - Everybody says that.

**Mrs TAYLOR** - We don't have boil-water alerts in Glenorchy or people who don't have wastewater services, and that is really where the bulk of that capital is going to go.

**Mr HIDDING** - But an hour or so ago we had evidence given here that the performance of the sewer treatment facilities in this area, if you put them up against all cities in Victoria, Western Australia, New South Wales - everywhere - they would be at 99 something per cent and his view is that we would be down around 30 per cent.

**Mrs TAYLOR** - We disagree.

**Mr PEARCE** - I think you would have to look at the infrastructure that we had. Our sewage treatment plants operated consistently to their licence conditions. If you want to change the rules and change the licence conditions then they weren't tertiary treated as you might want to do now.

**Mr HIDDING** - That is what he was saying, compared to -

**Mr MORRIS** - Contemporary licence conditions.

**Mrs TAYLOR** - That is correct but that is the licence conditions so it is not true that we were not, and we haven't changed the licence conditions with the new corporations. We have not gone to higher licence conditions.

**Mr HIDDING** - No.

**Mr MORRIS** - But we are expecting to.

**Mrs TAYLOR** - And we all would have been and in fact I am sure all the councils were expecting that that would happen as EPA changes over the next few years, that we would all need eventually to go to tertiary conditions. Yes, it is an in the future.

**Mr PEARCE** - I think we are not sure that the water and sewerage reforms will generate a massive improvement in water performance over a long period of time. I think over 20,



30, 40 years or whatever you will start consolidating your sewage treatment plants and you will probably get a better overall outcome from the corporate approach.

**Mrs TAYLOR** - Like the Taroona one that keeps on being talked about, and it is true. That is why we do not have an argument with the regional structure; it is just how it is applied.

**Mr PEARCE** - That is not to say that some of that could not have happened in any case because we were already in discussion with Clarence council on potentially taking our treated sewage across the river and distributing it through the Coal River Valley and that sort of stuff. So those kinds of shared services approaches were being discussed and could potentially have occurred under that previous model, but that is water under the bridge.

**CHAIR** - Your position is very clear in regards to Onstream and the lack of need for that corporation as it currently operates and obviously as part of your position the framework is, as I understand it, that as owners you need to be better represented in regards to the decision-making process, there are governance issues in regards to the way that the corporations currently exist and then there are inefficiencies as well within the structure, specifically Onstream. Are there other inefficiencies that you believe exist within the regional water corporation, Southern Water, that you would like to see addressed as well?

**Mrs TAYLOR** - There are obvious issues at the moment like, for instance, the billing system which no doubt you have talked about at length, and we keep on being told as owners, through our owners' representatives, that we are working on that and by the end of February or March or whatever the new billing system will be in operation. We can only take that on trust, Peter, like everybody else is because we don't have any inside knowledge of that and we have no way of questioning the corporation, but it seems highly inefficient. It seems a real problem that there are municipalities that haven't yet had water bills since July 2009. I think part of the issue there is that it was a very quick transition. When the Government decided that this should happen the time frame for setting the whole corporations up was very short. It would have been better to have given them a year longer, I think, so that they could have had those kind of things at least ready and in place before the starting date of July 2009, but 20 months after the start to still not have your billing system at all operational is pretty bad.

You may have asked them, I do not know, about the call centres, for instance. An obvious example to me that bigger is not necessarily better is that Onstream set up a universal call system which has now gone back to being held by the three corporations and I am sorry, but if you ring even Southern Water's call centre now it still is not hugely efficient. We had an occasion two weeks ago. Frank and I were out for a walk and we saw water coming out onto the pavement. We knew that it was not stormwater, which is the only thing that councils still control. When we got back one of our staff rang up Southern Water and had to wait more than 15 minutes for the call to be answered and then was told, 'You should talk to council about this'. He said, 'We are council'. They said, 'Well, you should check that it's not stormwater'. 'Well, it's obviously not stormwater. I'll tell you where it's coming from; it hasn't been raining', and so on. In the end it was dealt with.

We look forward to those things but, as I say, we have very little knowledge at the moment because we have no capacity to question the directors or the CEOs as owners.

**Mr MORRIS** - Clearly the owner's representative which you have on your behalf is not able to do that for you adequately.

**Ms TAYLOR** - Adequately, because it's an extra layer. Why would you do that? There are only 12 of us, for heaven's sake.

**Mr MORRIS** - You are asking the wrong people.

*Laughter.*

**Mr PEARCE** - I think there is also the issue of the owners' reps are representing 12 councils. We may have a different view so the owner's rep may not actually express our view to Southern Water. They might express what they think is more generally a middle-of-the-road view but it's fairly hard to get our own view onto the table sometimes.

**Mr MORRIS** - So the owners' representatives are all or predominantly councillors?

**Ms TAYLOR** - They don't have to be councillors but predominantly they are. We have one for the four greater Hobart councils.

**Mr MORRIS** - Do you have a mechanism for rotating?

**Ms TAYLOR** - Ours is Graham Bury - elected. I don't know how long his appointment is for.

**Mr MORRIS** - So you supported his appointment or collectively -

**Ms TAYLOR** - I voted.

**Mr MORRIS** - Yes, you voted.

**Ms TAYLOR** - So that person was elected.

**CHAIR** - I think your position is very clear. Certainly there is no doubt in my mind where your council is coming from in regards to this. Thank you very much for your time. It was good to see you.

**THE WITNESSES WITHDREW.**

**Mr DOUG CHIPMAN**, DEPUTY MAYOR, AND **Mr ANDREW PAUL**, GENERAL MANAGER, CLARENCE CITY COUNCIL WERE CALLED, MADE THE STATUTORY DECLARATION AND WERE EXAMINED.

**CHAIR** - Gentlemen, thank you very much for your time today and thank you for making a submission as well which the committee has already had a look at. Would you want to make some opening remarks to the committee? We have half an hour. There are some aspects in your submission that I personally would like to pursue in regard to development and other issues. I will leave it up to you to speak to the submission and then we will come back to questions from the committee.

**Mr CHIPMAN** - Thanks very much, Mr Chair, and I would like to formally place on record our thanks to the Chair and the committee for the opportunity to make a submission today. We feel that, as Southern Water's largest shareholder and also as the local government area in southern Tasmania with the greatest population, we have an input to make and we appreciate the opportunity to do so.

Thank you for having already read our submission. I will not go through that in great detail but I will ask our General Manager, Andrew Paul, to briefly touch on that. If I could say at the outset I think from an elected member's point of view of Clarence that probably the most important concern - and I know Andrew will touch on it - is the governance arrangements that are currently in place and the fact that we, as a major shareholder, have absolutely no influence in the direction of Southern Water. It really stings when the State Government comes out and says, for example, that councils own Southern Water and if they have a problem go and see them when we have nothing to do with it at all except own it. That is politically untenable and something that really stings. I will hand over to Andrew to make a few comments.

**Mr PAUL** - Mr Chairman, please stop me if I am repeating things that you already know or whatever but I did propose just to quickly run through some of the key points in our submission and I will probably do so fairly briefly in the interests of everybody here.

Firstly, as the Deputy Mayor has indicated, we do not support the current governance arrangements. We would like to see each authority governed by an independent board with no overlapping directorships. From our perspective it is not a corporate governance model that works that we can identify anywhere else adequately or appropriately and does not provide the correct separation of interests that we feel should be attributed to these types of entities. There must be significant cost and waste of time in terms of some of those key directors as a result and in the case of the chairman - and I am sure he said this this morning - it is our understanding that sometimes he can address the same issue at four different meetings and that can't be a productive use of either his time or the corporation's time.

To touch on the point: we are concerned that the current structure provides a disconnect between the owner councils and the boards of the corporation. Just in the instance of Southern Water, Clarence, Glenorchy and Hobart councils between them have somewhere in the vicinity of 65 per cent of the equity in that business but we are not represented on the board, nor are we represented in any of those three councils in the owners' representatives, so our capacity to directly influence or persuade or even deal

with the board as a collective group is limited by the current governance arrangements. It is our view that there must be some capacity for the major equity holders to have some greater input into the strategic direction and policy direction of Southern Water.

In terms of the operating structure of the corporations and Onstream, we remain unconvinced that Onstream is delivering benefits to the corporations that could not be delivered by the corporations individually or by the three CEOs simply agreeing to talk to each other on the phone and proceed down a particular path collaboratively. It would be appropriate for the committee, we think, to ascertain whether the efficiency gains of Onstream outweigh the additional cost structure to the system of the corporation. It is our view that that is highly questionable. We are also aware that in some circumstances the individual corporations themselves are starting to duplicate in-house some of the functions that Onstream is there to provide on their behalf.

In terms of the first 12 months' financial performance, we express some concern, as we have continued to do right from the outset, about the way the priority dividend payments are set up over the five years. I suspect you heard a vastly-different story from our Glenorchy colleagues just before lunch. We would wish to see that wound back, if at all possible, to the first three years of operation to ensure that all shareholders receive an appropriate share of any dividend stream as early as possible. Clarence is currently the largest equity holder in Southern Water but it is unlikely that we will see any significant dividend for the first five years, despite the size of our equity. We have about 22.8 per cent equity, Hobart is around 22 per cent and Glenorchy is around 22 per cent. Not that we wish any harm or disservice to Glenorchy, but we think it's inequitable that they are getting \$9 million worth of priority dividends and I think last year we got \$267 in dividends - it might have been \$367.

In terms of the structure, operations and legislation on the effectiveness and efficiency of the corporations and Onstream, we think Southern Water is about the right size in scale for a water and sewerage authority and it compares favourably in size with other mainland water corporations. We would not like to see Southern Water incorporated into one statewide entity. However, I should emphasise we would express no view in relation to whether Ben Lomond Water and Cradle Coast Water should be combined into one entity. At the very least we believe Southern Water should be left to its own devices, particularly in terms of size and scale. From our perspective and our residents' perspective there remains concern about the current billing arrangements. This needs to be addressed quickly before community confidence in the arrangements totally dissipates.

As to the terms of reference regarding a 5 per cent price cap, we see no easy way to resolve this short of the Government continuing their top-up funding or, at the very least, phasing it out over an extended time frame of, say, 10 years. Clearly, loss of that funding would mean that to maintain the existing levels of service Southern Water would need to either dramatically increase tariffs or not achieve the required return on their asset base. In that light, we think consideration should be given to reducing the expected return of 7 per cent to a more modest 3 per cent or 4 per cent, which is more in accord with what councils were achieving prior to the changes that took place 18 months ago. Even if that means extending the time frames to achieve the massive capital development program, we think that is worthy of consideration. Despite what we would contend or argue with the KPMG report, we believe we provided a return on asset of about

2-3 per cent year in year out prior to the change. Recognising that some of the assets were ageing, we believe that we had the capacity to renew those assets and continue to manage a suitable, satisfactory sewerage and water business at that rate of return. I am not suggesting for one minute that we should see a return to that structure, those days are gone, but I am trying to make the point that we think with a lower rate of return we could still run a sustainable business if some of the capital development thresholds were perhaps pushed out a little bit.

In terms of other matters - and I might be pre-empting your question, Mr Chairman - one of the concerns we have is that with the loss of water and sewerage planning capacity and particularly, given our inability to influence directly the strategic direction of the board, we are no longer able as a council to determine where development occurs within our city. In the context that it is really, at the end of the day, where water and sewer is to be provided that realistically determines where development is to occur. Further, we have lost a major economic development tool that we had in the sense that we can no longer use the provision of water and sewerage as an economic driver to foster development within a particular location within a municipality, such as was the case with Cambridge in 2006. Our strategy there was that we recognised that there was a demand or shortage in southern Tasmania of well-serviced, flat, highway-fronting industrial land. We made a conscious decision as a council to invest significantly in improving the sewerage, water and drainage infrastructure in that area prior to the boom in development we have seen in that area. We actually did work on the theory of 'build it and they'll come.' The point I am making, I suppose, is that without that capacity we are really reliant on the decision of a third party where we want to exercise some influences as a council in determining where economic development might occur in our municipality.

To sum up, our key points are that we would like to see the separation of the overlap directorships to create independent autonomous boards. We would like to see the abolition of Onstream, we would like to see the capacity as a major equity holder to have direct input into the strategic direction of Southern Water and we would like to see the retention of Southern Water as an independent corporation from the north and north-west corporations on the basis that it is at the right scale at the moment. That is a summary of the key points of our submission.

**CHAIR** - Before coming to the question on development, I am interested in your views on the weighted average cost in capital, whether or not that could be reduced from the 7 per cent return. One of the things - and Southern Water pointed this out this morning, as did the chairman and I think everybody around the table is well aware of it - the key drivers to price at the moment are obviously the amount of capital investment on the table and the time frame, the weighted average cost of capital and the 7 per cent return that we are driving for. In fact they would be the two, but then obviously the other impact on price is the dividend flow. You don't receive a dividend flow at the moment - well, no more than \$267, or whatever -

**Mr PAUL** - No.

**CHAIR** - What is your view as an owner? One of the things we heard this morning, and to place this question in context, was that if the levers all remain at their same setting, notwithstanding the fact that there is going to be a price shock with the 5 per cent dropping off on 1 July 2012, there is an expectation that costs will increase to the

customer at 10 per cent compounding per annum for probably the next 10 years at the current settings. That is going to be very difficult for many people, very difficult.

**Mr PAUL** - I think we would share that view.

**Mr CHIPMAN** - We certainly do.

**CHAIR** - As an owner, what is your view with regard to how you might manage if there were to be changes to the weighted average cost of capital, the percentage?

**Mr CHIPMAN** - There has always been this philosophical argument in council that on the one hand we were there to provide a service for the community and on the other hand it was a business we owned. To what extent do you use it as a money-making business that you own or to what extent do you operate it as a service. That debate actually influenced Clarence in setting a rate and we decided that we would make a very modest recovery on it, all of which got ploughed back into capital. For example, the profits we made out of the Water Corporation got ploughed into sewerage Lauderdale, establishing the Coal Valley Recycled Water Scheme and developing Cambridge. We didn't use it like some other councils did to actually cross-subsidise the general rate. That is why the article in the *Mercury* recently about the relative prices that different councils charge compared to councils on the mainland had Clarence at the bottom at about 54 cents per kilolitre and yet, guess what, we were making a small modest profit out of that cost. We find it very difficult and our residents find it difficult to understand that if we were providing the service at that cost, why is it going to cost three times as much as that at least under different arrangements?

**Mr PAUL** - The other point you were driving at in terms of the dividend, I think in roughly round numbers the dividend pool at the moment is about \$14.5 million. I do not have council instructions on this so I am crystal-balling a little bit but I would imagine that council would be quite comfortable if the dividend pool remained at that for a period of time. I do not think there is any expectation amongst my council that that will continue to grow at 10 per cent or whatever per annum; if it was left at that and we eventually get our 22 per cent worth of that, I think that council would be very satisfied with that type of approach.

**Mr CHIPMAN** - What we would be looking for is our fair share.

**Mr MORRIS** - Regarding council paying for water that it will use for sports grounds and the like, where do you stand on that? I am expecting that with the introduction of two-part pricing the council will also be eventually charged or are you currently being charged for some properties and not others? What is the current situation and what do you expect to happen?

**Mr PAUL** - We have certainly made budget provision this year to pay water and sewerage rates for our properties and we have traditionally had an in-house practice where we used to pay certainly a fixed component of the rates as an internal transfer process for many years. In particular in relation to your question of how do we feel about it, our expectation has been that we would eventually have to pay water and sewerage rates for those properties. I say we have made provision for it in this year's budget; whilst we

have made provision we had not yet been billed but I anticipate that we probably will be before the end of the financial year.

**Mr MORRIS** - So you have not had the discussion; you do not know whether you are going to be billed or not?

**Mr PAUL** - I personally do not. I suspect my finance manager does but I personally don't know the answer to that.

**Mr MORRIS** - Okay.

**Mr PAUL** - I have no expectation that we will not be, put it that way.

**Mr MORRIS** - Right.

**Mr PAUL** - The trade-off, however, to that is that we are also now billing Southern Water for rates on a range of properties that they have now taken over from us. What the net effect of that is I do not have a handle for the moment because like a lot of people I do not know what the future pricing of the water is going to be.

**Mr MORRIS** - Sure.

**Mr PAUL** - We I think accept the fact that there was always going to be some net impact somewhat similar to the new financial arrangements we entered into with the State six or so years ago where we started paying payroll tax and the like; the quid pro quo was that in return the Government started paying rates on a whole raft of properties. I will not diverge on that path but I hope that has answered your question.

**Mr MORRIS** - Okay, thanks.

**CHAIR** - Regarding that question about development, I think the point is very well made in regard to the industrial estate which you originally developed.

A number of developers around the State have raised a matter with me, in fact one particularly in the north, and I am just interested in whether or not this is occurring here as well. That developer in the past developed a number of 400- and 500-lot subdivisions. In the past they had been able to deal with two different councils and in both cases it was decided that they would open these subdivisions up to 100 lots at a time. Both of them required extensive works with water and sewerage. On the two previous occasions the two separate councils effectively charged the developer as lots were opened up. So with a 400-lot subdivision they charged 25 per cent once the first 100 opened up and so on but they would carry the cost initially.

**Mr PAUL** - This is under the headworks charge?

**CHAIR** - This is regards to headworks.

**Mr PAUL** - Thank you.

**CHAIR** - A developer I am aware of in the north of the State at the moment has a 400-lot subdivision but cannot afford to proceed because he has been asked to front the entire headworks charge up-front. Have you come across any similar issues like that or as a council how did you deal with subdivisional large lots?

**Mr PAUL** - Historically we had a bob each way in some respects. For large-scale developments going back in time the headworks used to become payable when the block was first sold by the developer to whoever purchased it. We changed that process about six or seven years ago and headworks used to become payable on the sealing of the titles when the new lots were in effect finally created. That resulted in it being staged because developers, being the canny beasts that they are and quite correctly and reasonably, never used to get the whole 100-lot subdivision or 400-lot subdivision settled at once; they'd get it done in 10-lot stages for a whole raft of reasons - land tax is one of them. In effect, the headworks charges became staged throughout the course of the 10-, 100-, 400-lot development. That's the sort of process I think you are outlining that traditionally occurred in the north. I am not aware of or I haven't personally heard how that's being dealt with at the moment; whether that's an issue or not.

**CHAIR** - There have been no major developments experiencing difficulties?

**Mr PAUL** - We've had some very significant ones and with very significant headworks charges. We've had a couple of developments where aggregate headworks charges I think have been in the vicinity of \$1 million to \$1.5 million.

**Mr HIDDING** - They are developer charges, not necessarily headworks only?

**Mr PAUL** - No, I am talking purely Southern Water charges in the sense that we isolate them as a separate line on our planning permit. We refer it to Southern Water and they say to us, 'These are our conditions' and we just put them as one section on the planning permit, so I am confining it to just that, not our additional charges.

**Mr CHIPMAN** - Andrew, you might like to talk about the ParanVille experience with Southern Water.

**Mr PAUL** - Yes. We've just gone through an application for rezoning in the large 400-odd lot subdivision - ParanVille. You will have seen it. It has been called, in the media, the Korean development out at Pass Road, Clarendon Vale, Howrah. Southern Water headworks charges in regard to that were about in aggregate \$1.5 million, which was about \$4 000 a lot which, to be honest, was pretty much exactly what we were charging as a council; in fact I think they're still using our old headworks policy. However, what was of concern to us was that allied to that was an application fee to have the plans and whatever assessed of \$60 000 for the various components of the Southern Water approval. That's in addition. The actual subdivision consideration was \$42 000 and then there was \$5 000 for sealing the plans and something else for this. In aggregate they were just under \$60 000. We would have charged about \$3 500 in comparative terms for that under the old system, but that's not strictly a headworks charge; that's another charge.

**Mr MORRIS** - Some of that will at least Southern Water will have to stump up like the sealing of plans at some point.



**Mr PAUL** - There's no question that there are engineering costs and whatever in terms of Southern Water, in terms of analysing the subdivision, analysing the sewage flows, water requirements and what impacts that is going to have on their reticulation system and indeed whether they can service the land or not but then the works that are necessary to do to service that are picked up under the headworks charges.

**CHAIR** - That's significant, isn't it.

**Mr MORRIS** - It is. Is that an up-front charge?

**Mr PAUL** - From my recollection at least two-thirds of it was an up-front charge. The sealing of the plans would obviously be a deferred charge and then there were infrastructure inspection charges and the like in addition to the headworks charges.

**Mr BEST** - At the start of your contribution you were speaking about separating the interests.

**Mr PAUL** - The point I was trying to make was that currently I think we have three common directors that sit on each of the three water corporations. As a director of each individual corporation, they are required to act in the best interests of corporation A, B or C. When they're acting as a director of corporation C are they necessarily always going to be able to make decisions that are in the best interests of both corporation C and corporation A. I think they are going to be torn between their loyalties at various times. I think it's the 'you can't serve two masters' analogy in how to allocate government funding or whether to apply for a grant or something like that. Which corporation are they serving? It's not a model that I see working anywhere else.

**Mr BEST** - What do you suggest?

**Mr PAUL** - I think each corporation should have its own independent autonomous board, quite separate of each other. Southern Water should have a board that services just Southern Water, in my council's view.

**Mr BEST** - But isn't that going to be more expensive?

**Mr PAUL** - I don't know. I wouldn't imagine it would be horrendously more expensive.

**Mr CHIPMAN** - It depends on the number of directors.

**Mr PAUL** - It depends on the size of the board and what you're paying them.

**Mr HIDDING** - It depends what you have saved if Onstream went away.

**Mr PAUL** - It's my understanding that the current common directors are being paid fairly significant amounts by virtue of the fact that they are serving three boards, not one. I don't know the exact numbers, to be honest, because I'm not involved in the engagement of them. I think in a matter such as that the dollars are incidental; you have to get the governance structures right.

**Mr BEST** - You're saying you have 65 per cent equity -

**Mr PAUL** - Collectively between Clarence, Hobart and Glenorchy we would have that amount of equity. Clarence is around 22.8 per cent.

**Mr BEST** - Which is still the highest?

**Mr PAUL** - Yes.

**Mr BEST** - But as a result of that you don't have representation on the board and you think that's a major issue given your 22 per cent?

**Mr PAUL** - We don't have any capacity to influence the board. We certainly don't have any nominated directors to the board. The current model provides for three owners' representatives to be the conduit between the owners and the corporation board itself. I make no comment upon the capacity of the owners' representatives; I have no doubt they're doing a good job and doing their best. The point I'm making is that the three owners' representatives in the south don't individually represent any of the three largest equity holders.

**Mr BEST** - Do you feel you can make representation now, though? This is a separate issue. You're saying you are not represented, and I accept and understand your point there, but at the moment you can make representation, can't you?

**Mr PAUL** - We can make representation but we have no capacity to make it happen. My council has a leaning towards the old Hobart Water-style model, where there was an expert board - and I'm not suggesting for one minute that the board should consist of councillors. It needs to be an expert board because this is a billion dollar business. In the case of Hobart Water, sitting above that, with fairly limited powers but mainly around approving strategic direction, approving their corporate plan and things of that nature, was a body called a 'joint authority' which had one representative from each of the eight or nine councils which acted as the strategic link between the councils and the professional board. That is one model and I'm sure there are other options as well, but at least as an owner of the entity that type of model gave us the capacity to influence the strategic direction and policy of Hobart Water. I think we would perhaps like to see the same type of model exist in this circumstance.

**Mr BEST** - Are you unhappy with the strategic plan and the way it's headed?

**Mr PAUL** - I wouldn't say that we're unhappy with it. I think council is unhappy with its capacity to influence what it may be now and what it may be in the future.

**Mr BEST** - So you don't really have anything, other than those policy issues about representation and so forth, that you would like to influence regarding the board?

**Mr PAUL** - There's no question that my council has asked that question. There are myriad things within the City of Clarence that we would like to more readily influence than we have the capacity to do at the moment.

**Mr BEST** - On infrastructure?

**Mr PAUL** - Yes, no doubt they would.

**Mr BEST** - So you are saying that you're unhappy with the way it is being managed?

**Mr CHIPMAN** - How do you get Seven Mile Beach on the agenda?

**Mr PAUL** - And that is just a matter of lobbying; we have no capacity to influence it. I don't want to use the word 'unhappy' because I don't know that council is unhappy but they would like to see a greater capacity to influence it.

**Mr BEST** - I am just trying to get to the bottom of where you are at, so that is okay.

**CHAIR** - Onstream, in its current structure, should it remain or not?

**Mr CHIPMAN** - We don't believe it should. We don't see how it is required by the three corporations. We don't see how it is saving money. There is a real concern that it is going to go away and develop something like Aurora tried to do in terms of a billing system - which really frightens us.

**Mr HIDDING** - In your submission you say that council is concerned that the first year financial performance of Southern Water appears to be less favourable than that achieved by the separate entities prior to the reform process.

**Mr PAUL** - That is not from a body of work that we have done. It is lifting from a body of work that the STCA did on behalf of the 12 southern councils where they looked at the aggregate profits that were made by the 13 entities - 12 councils plus Hobart Water. It was their view that the financial performance of Southern Water then was not as great as the aggregated performance of the 13 entities beforehand. I can't put numbers around that but I thought the STCA did in their submission.

**CHAIR** - Thanks; it has given us a clear idea of where you are at. There is a common theme emerging that we have heard right throughout the day, including from the chairman himself.

**THE WITNESSES WITHDREW.**

**Mr TONY REIDY**, CHIEF EXECUTIVE OFFICER, AND **Ms CATH McLEAN**, SENIOR RESEARCH AND POLICY OFFICER, TasCOSS, WERE CALLED, MADE THE STATUTORY DECLARATION AND WERE EXAMINED.

**CHAIR** - Thank you very much for your time and thanks very much for making the submission. Would you speak to the submission - obviously we have had a look at it - make clear to us any of the main points that you would like to and then we will have a number of questions that we would like to put to you, if that is okay.

**Mr REIDY** - Certainly.

Mr Chairman, I will make a couple of opening comments on behalf of the Tasmanian Council of Social Service. You will have seen from our submission that we see water and sewerage services perhaps a little bit differently to some of the people who have made submissions in that we see them as an essential service. They are fundamental to the health and wellbeing of communities and to individuals but particularly the provision of those services has a large impact on our key client group which are those people on low incomes and those who are disadvantaged in the Tasmanian community.

Our submission does go to some lengths to talk about the fact that we do need to minimise the cost of the provision of these services. We note the changes in the structure in the water and sewerage corporations, we understand the moves that are being made but in fact we recommend that we look at a structure for the delivery of those services which delivers them at the most affordable price.

There is obviously massive infrastructure development needed to bring water and sewerage services in Tasmania up to the sort of levels that are needed for a healthy and vibrant community but we do not think there is an argument that consumers should pay for the neglect of State government, local government and Federal government in the provision of infrastructure in this area. We understand that the under-spending on this infrastructure may run at something like \$1 billion and in fact all classes of consumer need to be part of providing that infrastructure to bring those services back up to par.

We have struggled with this issue of cross-subsidisation. Your committee may be able to inform us on this but we cannot see good information around about the extent of cross-subsidisation between various local government areas with regard to the provision of water and sewerage services. That does not help the argument because we are concerned that when that cross-subsidisation ends we may be in a situation where we could see the price of water and sewerage services go up as much as 30 per cent. That is of great concern to us when we talk about the particular people for whom we advocate.

**Mr BEST** - So are you saying that you believe from some of the modelling that you have done it will go up to 30 per cent?

**Mr REIDY** - I would have to declare that the modelling, if we could even call it that, is very rough because we do not have the basic information to work from but the little information that we have that has been provided to us enables us to look at that and we believe that it could be an increase as high as that, and we sincerely hope that it is not. We sincerely hope that those figures are exaggerated.

**Mr BEST** - You are canvassing your concerns.

**Mr REIDY** - We are very concerned about that because we know the impact that will have.

**CHAIR** - We heard evidence this morning that notwithstanding there will need to be an increase on 1 July next year when the 5 per cent price cap winds itself out, if settings remain the same, 10 per cent compounding per annum over at least the next 10 years, there will be a doubling in the price of water and sewerage in about seven years' time. That was directly from the corporation this morning. What sort of impact do you think that would have on those people that you represent?

**Mr REIDY** - The impact would be devastating. Well, I suppose there is a clear question. It depends how that impact is passed on. If the impact is passed on in those sorts of figures we have a serious problem with that very group of people in Tasmania who are the most vulnerable and least able to afford that sort of price increase. So we would be deeply concerned about that. I must say too that my colleague Cath McLean is sitting here with me as the Senior Policy and Research Officer at TasCOSS, and as I've been CEO of TasCOSS for about 10 minutes -

*Laughter.*

**Mr REIDY** - I wanted Cath to be able to freely contribute and I think it would help the committee if that was the case. Is there anything else on that issue?

**Ms McLEAN** - I guess the thing that has concerned us is that no-one involved in the debate has ever talked about the extent of cross-subsidisation yet. They may have to you but the extent seems not to have been made public. If the intent is to roll back the cross-subsidisation so that everyone pays for what they use and so on then we expect very significant sums to be involved. We don't know what they are; we're really guessing.

**Mr MORRIS** - The cross-subsidisation basically is from businesses cross-subsidising residences -

**Ms McLEAN** - Yes.

**Mr MORRIS** - small businesses in particular, city shops and the like cross-subsidising residences and there is a vast difference in price between some municipalities and others. In particular, the average water and sewerage rate in Glenorchy is about \$1 300 whereas in Hobart it's about \$800 to \$900. So Glenorchy is already in the order of 25 per cent -

**Ms McLEAN** - Is that households, Tim?

**Mr MORRIS** - These are averages. Unfortunately there is no separation between the averages. We haven't been able to get any data to separate the cross-subsidisation from businesses to households in order to establish the differences between households. However, I think there is no doubt from the evidence we've heard that households with a lower AAV are the ones who at the moment are probably being cross-subsidised the most. Some of them would be people that you represent very strongly.

**Ms McLEAN** - And including private rental?

**Mr MORRIS** - Yes, that's right.

**Mr BEST** - Have you got a proposal around people on healthcare cards or something like that?

**Mr REIDY** - I'll ask Cath to talk about our position on concessions.

**Ms McLEAN** - We think the whole issue of concessions for water and sewerage needs to be reconsidered. It is currently based on a proportion of the historical concession from property rates so it's a set I think \$150-something. It's in our submission. It's unrelated to usage so if and when two-part pricing is introduced that includes a volumetric pricing component we'd like to see a concession that's based on usage; maybe a two-part concession - one on the standing charges, one concession on that at a flat rate, and a percentage rate on the volumetric charges. I might add that we'd argue for that for electricity as well.

**Mr MORRIS** - We will come back to tariffs in a while, I guess.

**Mr BEST** - Whilst on that subject, is there some way of working out how much we'd need to set aside to subsidise and help these people?

**Ms McLEAN** - You'd have to work on a percentage. I think the local council rate is 30 per cent. Is that right?

**Mr MORRIS** - No, it was.

**Ms McLEAN** - It was.

**Mr MORRIS** - That was where that figure was derived from.

**Ms McLEAN** - That might be a start or the Government could decide to offer a 50 per cent concession.

**Mr BEST** - Do we know roughly what the numbers are - how many people we would need to help?

**Ms McLEAN** - We could look at electricity concessions. I didn't bring the figures with me.

**Mr REIDY** - It would certainly provide a guide.

**Mr BEST** - Yes, I'd be interested.

**Ms McLEAN** - I think about 70 000 households in Tasmania. I think there are about 150 000 concession cardholders, including pensioner cardholders.

**Mr BEST** - Yes, but that is obviously two people to a house and that sort of business.

**Ms McLEAN** - It is not exactly known. You could certainly do some modelling using electricity as a guide as well.

**CHAIR** - We have asked the corporations this morning and they provided us with an average price per household in southern Tasmania for water and sewerage of \$807 and then we have asked them to provide us with numbers of those people who might be below the average and those above. There is obviously a massive disparity in regard to what households currently pay. In fact the clearest indication this morning was that the 5 per cent subsidy meant for one customer -

**Mr MORRIS** - \$140 000 for one customer, which was the Government's 5 per cent cap.

**CHAIR** - The smallest was \$57 and the highest subsidy was \$140 000 for one individual customer, but obviously that is across residential and business.

**Mr BEST** - The other thing they mentioned - and I know it is not giving too much hope to the situation regarding the people you represent - was that as things move into place, when they have standardisation of equipment so they have not one sort of pump here and then different pumps for something over here, they will actually be more efficient over time. That will assist with the costs for people. The engineer gave a percentage figure for the efficiency of what he has seen -

**Mr HIDDING** - Measured against contemporary standards around Australia. It was 30-something per cent. Most large towns around Australia are at 99 per cent, yet down south here we are on about 30 per cent. That is against contemporary standards because today's licence conditions still allow secondary water discharge, so we are living in third-world conditions really.

**Mr BEST** - Obviously there are issues that you are raising, and we need to listen to those, but we are hearing from the organisation that over time the efficiency in costs will settle down to some degree. There is this issue you have raised, which is very valid, about the cost of subsidisation.

**Ms McLEAN** - But also the concern that consumers will be expected to pay for allowing past providers to allow the infrastructure to get into that kind of condition.

**Mr MORRIS** - But they did make the saving then; unfortunately we are having to do the catch-up. Approximately where Brighton Council is at with its charging is where the residential sector would be at across the south of the State if we were on two-part pricing now. That information is generally in the Economic Regulator's earliest report. That is the best estimates they have, that Brighton Council is roughly in the ballpark - and it is on two-part pricing now. So if that were spread across the southern sector that is where we would be sitting now, but we are still, in terms of achieving the infrastructure and capital works upgrades needed, facing massive price increases.

**CHAIR** - One of the things we all recognise as an issue is the ending of the 5 per cent cap. I note your submission talks about an appropriate transition process. Have you given some consideration to what and how that might look?

**Ms McLEAN** - Not really. We want to avoid price shocks and we are not quite sure how. We haven't done any modelling on how because there is not very much information, as you have discovered, on the extent of cross-subsidisation or about the actual need for improved infrastructure, so we do not really know the costs involved.

**Mr REIDY** - You spoke to the corporations this morning and you said there is not much information around, only the average et cetera. Will this information be made available to the committee?

**CHAIR** - Yes it will, four weeks before they have to submit their price and services plan, which will be at the end of May this year.

**Mr REIDY** - That will be made public?

**CHAIR** - That will be released.

**Mr REIDY** - That might then allow us to go to some of these issues and actually do some modelling and have a look at this issue.

**CHAIR** - That will be the price and services plan for the period commencing 1 July 2012.

**Ms McLEAN** - That is after the cap is lifted?

**CHAIR** - Yes. When the 5 per cent cap comes off, because the government subsidy has been cumulative over three years, we heard this morning that there will be on average around an 11-12 per cent increase for each customer before there is the normal increase, if you like, which is, as they explained today, another 10 per cent compounding. Are there any other mechanisms you can think of other than having government continue to provide some level of subsidy? How best do you think that should be managed to those people you represent?

**Ms McLEAN** - I think concessions are certainly the only way to go.

**Mr REIDY** - Notwithstanding all of the information that is available to the committee this process must not disadvantage those people who are already so severely disadvantaged. We won't harp on about it but everyone is well aware of the pressure already being faced by households around Tasmania through other processes and mechanisms outside the work of this committee. They are already stretched to the limit, so any notion of significant price increases in the provision of water and sewerage services is a very concerning thing, not just for TasCOSS and the members it represents but also for those households and the wellbeing of those families.

**Mr MORRIS** - Initially the Government indicated that it was going to move billing from the owner to the occupier of a house. As we know, at the moment the owner gets the bill, in the case of a rental property, and then passes that through the rental system, so it is not a separate bill for the tenant except where there is a volumetric excess or something. There are some people who get excess bills but generally it is factored into the rent. What is your position? Should it remain that the owner receives the bill and then factors it into the rent. I think the Government is perhaps inclined a bit more towards that but a decision certainly has not been made in relation to that. Are you happy to see that swap



over so that the occupier, not the owner but the tenants, receives the bill directly? If that is the case how do you envisage that they would be able to talk the rent down by an equivalent amount given that they are often on contractual arrangements?

**Mr REIDY** - Therein lies the problem. We are concerned that when the cost of the provision of the infrastructure is passed onto landlords, they will bump the rents up. Then when volumetric measuring of water usage comes in as well, and there will be some mechanism for passing that on, the rent is not going to come down so we are very concerned about that being a double whammy for people in private rental situations who in fact are among the most vulnerable in the State.

**Ms McLEAN** - I think it could be argued, Tim, that the infrastructure costs - the standing costs of the meter and so on - could be met by the landlord and the volumetric cost be met by the tenant. However, there are some problems. I went to a Southern Water briefing session a couple of weeks ago and I gather there are some problems with metering flats, for instance.

**Mr MORRIS** - There are a few blocks of flats that have a piping arrangement that does not allow for separate metering, so the body corporate will have to deal with those, but they are not particularly numerous and that does not necessarily create unreasonable inequities.

**Ms McLEAN** - Our concern is that, as Tony just mentioned, the rents won't come down.

**Mr MORRIS** - They are contractual obligations, aren't they, in terms of dollar amounts.

**Ms McLEAN** - Yes.

**Mr MORRIS** - There is no mechanism other than the landlord voluntarily reducing.

**Mr REIDY** - The broader point we are concerned about is that landlords - perhaps those who are a little more unscrupulous - will use this process to inflate the rentals on their properties past that rate which is reasonable.

**Ms McLEAN** - To get back to the question that you asked about how we might address this issue of increasing prices, the other issue is the notion of a lifeline tariff - and we have talked about this in relation to electricity as well - for essential services and that is a tariff structure that has a very low cost small first block that we call a lifeline or a human right tariff. Everyone is eligible for that and then as your usage increases the price does as well, so if you have a second block that still remains affordable that should be able to cover most usage and then cost recovery and so on is loaded into the increasing block tariffs. It gives a price signal about usage and about conservation but also when coupled with a percentage-based concession it can assist those households that have high usage that is non-discretionary - large households, for instance - and assist them in meeting the costs of their water usage. That is something that we put forward as an innovative and very different way of looking at water and electricity tariffs.

**Mr MORRIS** - We talked about that this morning and I have here a copy of the Capital City Water Pricing Table reported last July where it shows that Adelaide, Brisbane, Canberra, Melbourne and Perth all have that type of tariff arrangement where the first block is the

lowest. Canberra and Melbourne are on a day rate or they might be annualised or quarterly. You have a low tariff for that first component, so if you use very little water you do not pay a lot of money on the consumption charge, but then if you choose to use more than what is considered to be basic then you pay extra for that extra volume - not for the whole lot but for the extra volume.

**Ms McLEAN** - One of the problems with that is for large low income households unless there is an adequate percentage-based concession coupled with that.

**Mr MORRIS** - Yes, a concession that recognises the number of people per house but still even if you have a slightly larger house you don't really use much more in the washing up or the clothes - you use a bit more but you don't still have to use huge amounts just because you have a few more people in the house. But the concession system really is the only way I think to resolve it.

**Mr REIDY** - That is right. We think a lifeline tariff coupled with a concession system but we think one of the great things about the lifeline tariff, as Cath mentioned, is that if one of the objectives of this whole process is to reduce the amount of water used by households, there is a real incentive in there to do it through that process.

**Mr MORRIS** - Unfortunately, the Chairman of Southern Water suggested they are not looking at that. They are looking at having a flat rate per kilolitre tariff so your suggestion here in your submission is not being considered currently, unfortunately.

**CHAIR** - On cross-subsidisation: obviously to wind out cross-subsidies will take some time - well, you could do it quite quickly and then there would be severe price shocks for some and others would be winners. I think what you are saying is that at the moment you do not have sufficient information, similar to ourselves, as to what number of individuals are affected, what number are paying less than what they should, what number are paying more than what they should. Like us, you are in a position where it is difficult to draw any real sense as to what sort of time frames it might take to wind cross-subsidisation out and how that might be managed.

**Ms McLEAN** - That is for sure.

**Mr REIDY** - But you'll get that information, won't you?

**CHAIR** - There should be a pricing plan, as you say, and services plan available a month before it needs to be at the Economic Regulator. That is what we've been informed today and that should be around May of this year.

**Ms McLEAN** - We fear that cross-subsidisation is quite large but we don't know that. If the intention is to wind it back - which it may or may not be, but I suspect it is - then there could be real problems for low-income households if it's not done in an incremental staged way over a long period of time. I couldn't put years on that.

**Mr MORRIS** - Or if there is a suitable offset that can take the pain out for those who simply can't afford it.

**Ms McLEAN** - There could be differential pricing for business and households, for instance, as there was for electricity until recently. That's an option but that may involve cross-subsidisation as well. We also said in our submission that we support postage stamp pricing, which obviously involves some kind of cross-subsidisation so we're not against that cross-subsidisation per se.

**Mr REIDY** - Particularly as we don't want to see people in certain geographical areas punished more than people in other geographical areas because that particular local area allowed its infrastructure to run down more than some other place. That's just not right.

**CHAIR** - That was one of the reasons that we've asked for that information as to how many winners and losers there are on either side of the average price that each residential customer pays. Once we're armed with that we can get some sort of understanding as to how many people are going to be affected. Unfortunately, I suspect there will probably be more losers than winners.

**Mr REIDY** - Yes, that is what we fear too.

**Ms McLEAN** - Certainly amongst households.

**Mr MORRIS** - It certainly appears from where we are at the moment that Clarence is one that's not going to have such huge change, perhaps. Even though it's on an AAV system it's nearer the pricing arrangements for the future, but Hobart would appear to be one that has actually used its rate income to subsidise water and sewerage, so it's the Hobart municipal area, from my perspective, where there will be significant shocks.

**Mr HIDDING** - Unless they want to make a contribution, of course.

**Mr MORRIS** - Well, they could, yes, to soften the bite.

**CHAIR** - We might deal with that through our recommendations. We'd better not get in front of ourselves.

**Mr REIDY** - As a final compelling point to the committee we say again that any changes that are made, we do stress, must not exacerbate disadvantage that already exists in the Tasmanian community, because the disadvantage is serious and widespread. We are the principal advocates, I guess, for that in the community. We will work to keep ensuring that that is not the case but we ask the committee to take that into the strongest consideration when they look at the information that is provided to them.

**Mr MORRIS** - Just for clarity on the group of people we are looking at, are health care cardholders and pension cardholders the two groups that we should -

**Ms McLEAN** - Yes, pretty much.

**Mr REIDY** - Largely.

**Mr MORRIS** - Are there others?

**Ms McLEAN** - Yes, there are.

**Mr MORRIS** - How do we identify them?

**Ms McLEAN** - That's the difficulty. Low-income households and those who perhaps don't have a consistently low income to qualify for a low-income health care card but may have seasonal or other variations in their income. It is very hard to identify except by some kind of means test. I'm not sure how you can identify these people.

**Mr MORRIS** - So there is another group out there who are sometimes in difficulty and sometimes not in difficulty.

**Ms McLEAN** - I would think so, yes, or who over a period live on a consistently low income.

**Mr REIDY** - They live pay to pay, whether the pay is government benefits, which is about 34 per cent of Tasmanians, or people who are on low incomes.

**Mr MORRIS** - But they'd be getting an appropriate card, wouldn't they?

**Ms McLEAN** - Yes, they would.

**Mr MORRIS** - Should we differentiate between different groups on different cards?

**Ms McLEAN** - I wouldn't think so.

**Mr REIDY** - Working off those two cards would certainly be the most helpful indicator.

**Mr MORRIS** - Right, thank you.

**CHAIR** - Thank you very much for your time.

**THE WITNESSES WITHDREW.**

**Ms MARY MASSINA**, EXECUTIVE DIRECTOR, **Mr ROBERT ROCKEFELLER**, AND **Mr MATTHEW PAGE**, PROPERTY COUNCIL OF TASMANIA, WERE CALLED, MADE THE STATUTORY DECLARATION AND WERE EXAMINED.

**CHAIR** - Thank you very much for coming along today. We have obviously received your submissions and, Robert, I think we received one from you separately as well. We have half an hour, we have read it and over to you if you would like to make some opening remarks, talk to the submission and make the main points that you would like to make and then we will follow up with some questions.

**Ms MASSINA** - Thank you very much for the opportunity to come and address the select committee. Water and sewerage reform has been one of the major policy reform agendas of the Property Council and to that in a nutshell from our perspective the most important thing is that the services provide the service at the lowest possible cost to all Tasmanians. Therefore we are very supportive of one entity in terms of getting economies of scale and getting that cost base down for Tasmanians. We also see that there needs to be a transitional period moving towards the two-part pricing and to address the cross-subsidisation within and across property prices but also across municipalities.

We are firmly of the view that there needs to be postage stamp pricing throughout the State and it should not be based on water catchment areas, council boundaries or even regions.

We also believe that the owner of the water and sewerage service needs to be putting increased money into the provision of infrastructure. That means that we also believe that under no circumstances should the entity be providing any dividends or any money towards government on the basis that every single cent that is raised goes back into the provision of infrastructure, therefore that will bring down the cost of the service to all Tasmanians.

The other important element that we would like the select committee to remember in your deliberations is the fact that water and sewerage entities are developer entities and developer authorities in some respects because they make decisions as to where development will occur and that also influences the pricing, particularly in the case of developer charges and levies.

What I am going to do as you have read the document is basically get both Matthew and Robert to give you a rundown of the asset from our perspective, our position on the assets, the dividends, the developer charges and the efficiencies.

**Mr PAGE** - In respect of the corporations' assets estimated to be worth some \$1.7 billion, the majority of those are older, antiquated assets that have been valued on a replacement cost basis, no doubt less a depreciation factor. One of the issues in structuring the balance sheet, the value of the corporations in regards to those particular assets is to therefore consider or to at least question the efficiency of those assets compared to a new standard of asset and therefore in an open market situation say, as I would as a valuer when pricing these sorts of things, what is a realistic value for these types of assets. So the question around the asset value base and therefore the subsequent dividend, which we will discuss in a moment, is something to be questioned or at least further considered.

In the instance of a number of older-style assets they are a money pit, they cost money, there is an ongoing cost in maintaining and repairing those facilities compared to new and whilst that is all well and good for me to say because you have to allocate capital to afford that, the dividend issue that Mary was just mentioning before is one where if retained earnings are held to help fund capital and develop the new assets we might be talking about a more realistic asset base, and out of that comes the greater efficiency and what we would expect to see or what we would hope to therefore see is this lowest cost provided to all Tasmanians. So in the instance of an old asset it doesn't or should not attract the same sort of level of pricing or value per se as compared to a newer asset where you have greater efficiency, greater economy. If you have, say, 20 pump stations and you have 20 treatment plants that have been inherited by the corporations from the local government authorities today then in the future a conglomeration of those into say one more modern facility of each of those types is going to assist in creating that efficiency. That is the point about the assets.

**Mr ROCKEFELLER** - Just taking Matthew's point further, we have to get from here to there and to do that requires an enormous amount of capital. What we also have to do as we go there is lower the operating costs for all consumers because when you look at it we have extremely inefficient, inappropriate plant and equipment throughout the State. If you just look in southern Tasmania we have 14 water and sewage treatment plants when in fact there should be one or two. So what you have is these water corporations having legacy assets which have high operating costs. Taking Mathew's point as a valuer, they are not state-of-the-art, low-operating businesses. If there was competition in the marketplace, those assets wouldn't be worth anything today because the entrant who had a highly efficient business would be able to supply the goods and services at a lot lower cost. If you drive along the Brooker Highway the road goes straight between Hobart and Glenorchy and between Glenorchy and Brighton, but when you look at some of those water and sewerage pipes they make a U-turn, a right turn or a left turn. If people had seen that they would have done something about it over the last 100 years. You then say you have these corporations and everyone says, 'We deserve a dividend'. Do you really deserve a dividend when you have misused ratepayer and local government, State government and Federal government money so poorly, where you couldn't talk to each other to make proper capital decisions? Over and above that you have to reduce your operating costs to deliver that service for the next 50 or 100 years at the lowest possible cost. It means that no-one deserves dividends, whether it's a State government corporation or a local government corporation. These assets need to be quarantined. You have to get the confidence of the people. There is no confidence of the people in these assets in the way they are being operated or the way they are being treated because everyone sees them as a money spinner for them, or a possible money spinner. The assets need to be quarantined for the next 50 years or whatever by legislation and then all the money is retained. When you look at where it has to move to, to deliver the service at the lowest possible cost, it requires hundreds of millions of dollars of capital. Who is going to provide that capital? It translates both to the State and the Federal governments, but over and above that somehow you have to work over the next, say, 10 years to do away with the cross-subsidies within the class, so within a municipal boundary. You have problems within that class - it might be residential, commercial or industrial - between classes - that is, between commercial and residential - and then you have the problems between municipal boundaries. You try to soften the blows, because there are winners and losers, but the impacts are so huge and even over a

10-year period you have to take an enormous amount of time to get there but it requires an enormous amount of capital to be able to do it. Through all those things - the dividend policies - you have to be delivering efficiencies so that we get to an efficient cost base and operating base sometime; whether it is 10 years or 20 years, you have to see those time frames.

Over and above that, what everyone forgets is that the water and sewerage corporations are developers. They allow development to occur in this State. We need to have development in this State and we need to be delivering those costs at the lowest possible price so that the home is affordable to people, so that commercial development is affordable. What we have to be doing is having developer charges at a reasonable price but if they're locking into an inefficient system then their costs are going to be much larger and higher than they really should be. We need to be thinking like, 'I live in Hobart but I invest throughout the State'. We don't want a situation whereby if you invest in New Norfolk it is a really high pricing so you invest somewhere else. We want to have a very dynamic economy delivery and allowing developers to develop at a reasonable price because we are competing for capital against Victoria, New South Wales and Queensland. If they are treated as utilities - how do we rip people off throughout the system to get the capital to pay dividends to local or State governments - we are going to strangle ourselves because the land tax won't be as much and the rates to local government won't be as much, nor the stamp duty and payroll tax, Knight Frank's valuing business won't have as much activity and the Property Council won't have as many members. We don't want to be there; we want to have an efficient business to deliver very good outcomes for all.

**Mr MORRIS** - If the corporations did not pay dividends back to the councils then presumably, on the basis that the councils would provide the same level of services that they currently are, and that is another argument altogether, they would have to adjust the rates accordingly if the profits they are receiving from the corporations are effectively subsidising the rates?

**Mr ROCKEFELLER** - The question you have raised is perfect timing. As a property person, I point out that water and sewerage is still charged effectively as a rate, as an AAV. So you have to look at what your total cost of occupancy is - of rates and water and sewerage. If I take a shopping centre in Maitland or in Newcastle it is costing me anywhere between \$12-13 a square metre and \$18 a square metre for the provision of those services. If I am in Glenorchy, I am at \$42 per square metre, and these are equivalent shopping centres. If I am lucky enough, which I am, in relation to a joint venture with Tasplan, to be in Clarence, it works out to \$47 a square metre. We are talking about 200 to 300 per cent more. Local government has to demonstrate whether they are delivering services at the lowest possible cost to their ratepayers.

So all this is quite interlinked. The point you have made, sir, is that they might not be getting a dividend, but the question is, do they deserve a dividend? Are they operating their business efficiently? I question it. I question where they benchmark and who they benchmark. An AAV is effectively a standardisation model. If you look at Hobart, it is at 7 cents in the dollar today. Glenorchy is at 7.1; that is a 10 per cent differential. If you go to a place like Clarence, it is close to 9. That is a 30 per cent differential. If you go to Burnie they are at 11, so you are at 50 per cent. So you have to question the entire models here. It is no different to what has been in the papers over the last few days; we

are into a very high operating cost environment. So it is having impacts on business but also on the residential person, and a lot of Tasmanians, 52 per cent, are on some sort of fixed income. So we have locked ourselves into a very high operating environment in which the costs are growing a lot more than the fixed income. So we should all have a good look at ourselves, which includes the whole local government structure, the whole water and sewerage structure, the whole government structure. As a business person, I am looking at my structure every day about how to take my costs out because my margin squeeze is significant. So I have to somehow figure out a better way of doing business.

**Ms MASSINA** - Realistically speaking, if the councils, as owners, are serious about providing the infrastructure that is required to get rid of the 23 boil-water alerts and place infrastructure in areas that have had minimal water and sewerage infrastructure, and if we want to see development occur, which requires new infrastructure, then how important is it to them that there is the capital required to provide that infrastructure? At the moment it would seem that there is \$1 billion worth of infrastructure requirements before the water corporations, so something has to give. Realistically speaking, if you look at poor decision making in the past that has left us with a legacy of poor assets and questionable asset value, then you have to ask whether you reward by virtue of dividends or you place that money where it is required, which is back into the infrastructure. It is one of the vital issues that I think this select committee needs to provide a recommendation on because ultimately the lack of infrastructure or the cost of infrastructure through developer charges where you have seen it go from \$500 a residential lot to \$2 000 and then in some commercial areas it is as high as \$600 000 to \$700 000 all affects the ability for further investment but probably more importantly it means that Tasmanians who want to buy a house in a greenfield site are having that affordability questioned because that cost rolls into the house price.

**Mr MORRIS** - Are you suggesting that the corporation should or should not cross-subsidise new developments by not using direct user pays of the cost for those headworks and related charges?

**Mr ROCKEFELLER** - At the present time, speaking from experience, how the pricing is done is questionable. Then the other factor is you are also subsidising legacy assets, so you are subsidising high costs. For example, the developer charges in a place like Newcastle compared to the developer charges in a place like Kingston are significantly different.

**Ms MASSINA** - There is no consistency in terms of framework around developer charges statewide.

**Mr MORRIS** - There is now, as I understand it. My understanding is that the three corporations are all working towards an Australian standard for developer charges, for the headworks charges.

**Ms MASSINA** - But whilst they are working towards it, we have inconsistency across the State.

**Mr MORRIS** - Historically we have had a huge inconsistency where the north of the State traditionally had not charged any headworks charges and the south has had a mishmash but generally has charged some.



**Mr ROCKEFELLER** - The fundamental question is we have to be providing our services, whether they are developer charges or whether they are the operating costs, at the lowest possible price and just because someone else wants a dividend interstate, or whatever, we have to say, 'We see this as an important issue, we need development here, we need economic activity, how can we lower our costs?'

**Mr MORRIS** - But it is not by cross-subsidisation, is it, it is by lowering the real cost of providing the infrastructure.

**Mr ROCKEFELLER** - That is exactly right.

**Mr MORRIS** - Not gross. The thing I am wanting to get clear is that we can reduce the cost by cross-subsidisation as well, but we are not arguing for that and you are not arguing for that.

**Mr ROCKEFELLER** - No, we are talking about real costs delivery, and that's what the focus should be on, and that is what the KPI should focus on. Whatever it is on the mainland we need to be under it. That is the goal and objective.

**Mr MORRIS** - Therefore the water and sewerage corporations should not be cross-subsidising the council rates by a dividend?

**Mr ROCKEFELLER** - That's right.

**CHAIR** - That was a very good presentation.

Everybody is aware that businesses currently cross-subsidise in residential. Have you given thought to what would be an acceptable time frame to wind that up? You mentioned 10 years.

**Ms MASSINA** - Yes. We have been toying with that time frame. Obviously nirvana would be tomorrow but that is not going to happen. What we want to do is try to avoid huge price spikes and I think the Economic Regulator, when he was making his initial assessment for the drawing-up of the IPO, basically said that realistically 10 per cent is not even break-even. So the Government put 5 per cent in - the 5 per cent cap - and realistically speaking if that 5 per cent cap was to come off when it is scheduled to, from our perspective there is absolutely no guarantee that the prices will not go up 15 per cent, if not more, which is going to dramatically impact. To get back to your question, if we could have a guarantee that said, 'This is the timetable for winding back cross-subsidisation within the classes', say, commercial to start with and then residential, because residential is obviously where we are going to feel the impact.

**Mr ROCKEFELLER** - Not necessarily. To be able to do this you have to attack everything; you have to be reducing your cost structures in getting the maximum efficiencies. You have to ensure that you are putting capital into it - for example, retaining your dividends and giving additional capital, which is effectively what has gone on with the government price cap. They are effectively putting capital in, even though it is being used for operating, so they will be able to unwind. There are many instances where residential is cross-subsidising residential. This system is not fair today and the

concept that it is fair is that people do not understand the industry. Commercial subsidises commercial in many instances where commercial users who are using huge amounts of water do not pick up the appropriate fixed costs of the system. Councils, just to put it into perspective, were charging to high users - I am not sure what they were doing in the last two or three years - at the marginal cost of water. They buy from the old authority at 48 cents per kilolitre - 1 000 litres for 48 cents, you think about it - and they are selling it at 52. Yet someone else is paying \$8 a kilolitre for that same water because they are picking up all the fixed costs. I will tell you what, when it comes to doing a bottle of beer and you compare it to interstate, what the cost is for water in Brisbane, Sydney or Melbourne, does it make any difference that it is at that price of \$1.50? It means that they are picking up more of the fixed costs. It shows that local government did not understand their business, they did not price their business properly.

Just to put it into perspective, what is going on here is in many instances local government is not paying for their water today. They are the main water consumer in the State, they are the shareholders and they receive dividends yet they do not pay their fair share for their water.

**Mr MORRIS** - We have just found out that Clarence has budgeted for it this year.

**Mr ROCKEFELLER** - They may have budgeted but I will tell you what, to think this sort of practice has been going when under National Competition Policy they were supposed to be doing it under the CSOs and everything, the regulator was asking for it but he had no enforcement provisions, these assets have been used and abused by local government for a very long time and to think that they should be rewarded in some way is disgraceful.

**Mr MORRIS** - They are charging rates, however, to the water corporations.

**Mr BEST** - I have the point very clear that you have made. It has been interesting, though, because we have had some submissions today from local government. I am pretty sure that I know what you are going to say but I will put the question to you anyway. Their concern is really the current arrangements and they feel that they do not even have proper representation; they want representation on the board and further say in strategic planning and that sort of thing. What are your thoughts on that?

**Mr ROCKEFELLER** - I think you have to go back 10 or 12 years, look at the studies into the corporatisation tests, the studies into two-part pricing, analyse those studies and then come to the conclusion as to whether you think they deserve that type of thing when you look at their performance in those areas 15 years ago. They do not have the capacity or the understanding of this.

**Mr MORRIS** - You are harsh but probably correct.

**Mr ROCKEFELLER** - When you review this industry over a long period of time and think where it is today, to think that we have sewage treatment plants right next to each other from different councils and they had the capacity to talk to each other, you have pumping stations, you have reservoirs where they could talk to each other when they are planning major capital investments, really you have to question their capacity. And who are they looking after? Are they looking after the State? Are they looking after their regions? Are they looking after their ratepayers? You have to question their drivers in the way

their behaviour is. If the State does well, my business will do well. If the State does well, I believe that every person in Tasmania will be better off. That is what the goal of local government should be.

**Ms MASSINA** - I suppose in some ways they have the ability to influence the way that water corporations do their corporate infrastructure plan which, as I understand, all three need to provide for the next 20 years. They do that through land use planning and they should be doing it through the regional land use strategies that all three regions and the councils within those regions are supposed to be working on. So they have the ability to influence the strategic decision-making process.

**Mr PAGE** - Or their part of it.

**Mr MORRIS** - We are clear about your position in relation to the two-part pricing but in relation to the consumption charge side of things, we have TasCOSS arguing there should be a stepped tariff with a relatively small volume available at the outset at a very low charge for those who are least about to afford it and then stepped tariffs beyond that - at least a two-step tariff system. We have a situation on the mainland where you have everything from a single tariff level to four or five different pricings at different volumes, which obviously send different signals in terms of water use and conservation. Do you have a particular preference or opinion?

**Mr ROCKEFELLER** - Think about this: with electricity today about 50 per cent of your costs are now fixed. It means that if you invest in energy-efficient lighting, airconditioning or heating et cetera your return is cut by 50 per cent. If you had 100 per cent variable pricing, you would double the return and there would be far greater investment in energy saving ways. Even my children might learn to turn off the lights because it's going to save even more money. There are all sorts of economic theories. Utilities want to lock in their returns and those sorts of things which is why 50 per cent needs to be fixed. I question that philosophy if we are really serious about reducing our carbon footprint and waste.

For water and sewerage it is much the same. What you want to do is empower consumers to reduce their operating costs. What always gets forgotten - it is like the cost-benefit test with water meters - is that the real cost of the water and sewerage is in the wastewater treatment. If you can reduce the water going in, it reduces the water going out. You have to start getting the signals, and as much signal as possible, to reduce that consumption. What I can't come to terms with is that you can go to the supermarket and pay \$2.50 for 600 mls of water. I can turn on my tap and I am paying \$1 for 1 000 litres of water. Water is the cheapest thing everyone uses. A higher variable will end up creating a better pricing system. That is sending the right pricing signals. A higher fixed cost ends up meaning that the people who use the most water aren't carrying their fair share.

**Mr MORRIS** - Should the pricing reflect the real cost? Should the fixed costs reflect the cost of providing the infrastructure and the supply charge reflect the cost of supplying the water or should we see the supply charge being subsidised or vice versa?

**Mr ROCKEFELLER** - It is the goals and objectives you are trying to achieve. It is a bit like the telephone; you have this high fixed-line charge. To my brother's children it is

the best charge he can have because the cost per call is really low. But to the pensioner who only makes a couple of calls a week it is the most expensive phone cost. So they are the things to balance up. When you are talking about something which is only costing \$1.50 or \$2 or whatever it is for 1 000 litres, it is quite immaterial. People do not realise how cheap the actual charge is.

**Mr PAGE** - The closer you can get to variable costs and fixed costs is obviously the ideal scenario. In terms of the question, it is also a factor of the economic life of the infrastructure as to what the fixed component ought to be. So that is just part of the formula. If it costs \$2 million to install a pump, what is its economic life, subject to return, repair and maintenance, for a sinking fund? It gets back to this issue about dividend and how much of that should be perhaps allocated to a sinking fund to increase the longevity of the asset, because we all know if you repair and maintain it then it lasts longer and that can bring down your fixed component also. So there are a number of variables and machinations that would go into that issue.

**Mr HIDDING** - No hard and fast rule?

**Mr PAGE** - No, but you have to be in it for the reinvestment into capital into infrastructure to bring those costs down.

**Mr HIDDING** - The evidence from the water corporation here in the south is that they are spending most of their time trying to manage price shocks as the policy changes. There are government agencies such as State-owned companies - Metro, for instance - that give subsidies to various classes of the community. The government pays for that because it is transparent and it is good management. The government says, 'I want you to carry all children under the age of such and such and I want you to carry pensioners for so much and we will pay you for that'. We heard in evidence today that they are struggling with the price shock thing. They need to deal with the Economic Regulator too because he is interested in price shock. I can see why that is the case but at the end of the day it is about politics. Someone is going to scream when it goes from \$300 to \$900. Why is it that they and you appear to have put your hand up and said you will accept a 10-year introduction of our transition, when actually the policy change puts equity back into the system for small business out there that is not necessarily represented by the Property Council. He sees the policy change coming. He or she sees the meters coming, the two-part pricing system, and says, 'Thank heavens, as of next year I will not be paying for water I do not use'.

**Mr ROCKEFELLER** - The cost subsidies are so horrendous and so entrenched that you need an enormous lead time to be able to overcome them.

**Mr HIDDING** - Ten years?

**Mr ROCKEFELLER** - Yes and that still does not mean that the Government will not have to put in, which gets back to the capital. They will still have to put an enormous amount of capital in to overcome this. You have to retain the dividends, so one aspect is that the dividends could be used to lower the price shocks but then you still need the capital to do the investment, which means that the Government then has to be putting in the capital. Alternatively do it around the other way: the dividends release the price shocks a bit more and the capital is then put into actual infrastructure.

**Mr HIDDING** - Could it not be argued that a small business owner, in hearing you say that you are offering to have a 10-year transition, will say that lets the Government off the hook? They are never going to put the finance in that is required because the beneficiaries of the policy change are prepared to have a 10-year lead time to actually soften other people into it.

**Mr ROCKEFELLER** - The Property Council is the voice of reason.

*Laughter.*

**Ms MASSINA** - I do actually believe that it will take 10 years to wind back cross-subsidisation. If it happens before -

**Mr HIDDING** - It's not going to be any quicker than 10 years. If you say 10 years then they will grab every one of those 10 years with great glee, and they have already.

**Mr ROCKEFELLER** - We have lost 100 years so what is another 10 if it is done right?

**Mr MORRIS** - How in the south do we do that at the same time as full two-part pricing? Aren't these two things so tangled together? Do we do the two-part pricing first and then unwind the cross-subsidisation or do we go the other way around?

**Mr ROCKEFELLER** - The fixed component will actually be attached to your AAV and so the AAV will actually taper off.

**Mr HIDDING** - The AAV effect would taper off.

**Mr ROCKEFELLER** - That is exactly right.

**Mr MORRIS** - That is very helpful.

**CHAIR** - Thank you for that; it is always a pleasure.

**THE WITNESSES WITHDREW.**